

ACADEMIC RHETORIC IN THE POLICY ARENA: THE CASE OF CAPITAL GAINS TAXATION

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Economic policy is essentially politics in the real sense.

— Oskar Morgenstern

Politics, very often, is simply economics pursued by other means.

— Edward Nell

Economics, as the Greek etymology suggests, owes its advent to an interest in the management of everyday life. More than two millennia later, Alfred Marshall reaffirmed that economics is best seen as the “study of mankind in the ordinary business of life” [1920, 1]. Since Marshall, economics itself has become domesticated. Political economy has been remade into a professional discipline called economics, and, concurrently, economics has been transformed into an academic enterprise, which it remains today. Our topic is this: what role, if any, does academic economics play in everyday life? We focus in particular on that most unusual aspect of everyday life, politics. What role does academic economics play in political life, and, especially, how do economists’ ideas enter and shape political debates about economic policy?

Our investigation is rhetorical in design. We mean “rhetorical” in the sense pioneered by Donald McCloskey [1983]: economic discourse comprises a far richer variety of argumentation than syllogism and measurement, which are the official modes of our contemporary academic discourse. Metaphor, narrative and other “unofficial” rhetorical devices are also crucial to an understanding of economics. Thus, a closer examination of *all* aspects of economic and political discourse will yield fresh insights into how the products of academic economic research affect the policy process. The capital gains debate of the late 1980s is our case study.

THE PROBLEM: A RHETORICAL GAP

The conversation between academic economics and politics is not what economists and political leaders expect or desire it to be. A rhetorical gap divides us. Stuart Eizenstat, who served as an advisor to President Carter, observed that "[e]conomists and politicians too frequently are like ships passing in the night, neither understanding the needs of the other" [1992, 71]. Another Washington veteran, Alice Rivlin, noted in her presidential address to the American Economic Association, that "[e]conomists and political leaders not only miscommunicate, but each accuses the other of incompetence, obfuscation, self-serving motives, and anti-social behavior" [1987, 1]. This rhetorical gap, and the recriminations it inspires, figure prominently in the stories told in seminars and lunchrooms "inside the Beltway."

The stories that economists tell about their experiences in the political arena comprise three related themes: waste — much of what we produce in academia is not used in politics; ignorance — the economic knowledge of politicians is superficial at best; and ineffectiveness — political argument tends to crowd out economic argument. Situated in an academic institution that stands within one mile of the U.S. Treasury, White House, Federal Reserve, International Monetary Fund (IMF), and World Bank, the authors hear variations on these themes all the time.

One colleague, who recently moved from academia to join the staff of the IMF, confided that he could write off 90 percent of the human capital accumulated in graduate school. Like many policy economists in his position, he noted that the economic knowledge required for his position did not much exceed the level of an undergraduate course in principles. Remarks in this vein were recorded by William Allen [1977], who interviewed about 60 government economists working in the government. Lee Hansen, who had served on the staff of the Council of Economic Advisors, was representative: he told Allen that all an economist needed was "just good common-sense economics" [ibid., 70]. Fifteen years before Allen's survey, Alain Enthoven said of government economists: "The economic theory we are using is the theory most of us learned as sophomores" [Rhoads, 1985, 217]. Ten years after Allen, Robert Nelson [1987] argued that newly-minted PhDs entering government must be taught to unlearn their advanced training — "deprogrammed" as it were.

Alan Auerbach, an academic economist at the University of Pennsylvania, served in 1992 on the Joint Committee on Taxation. While still on the Capitol Hill he wrote about the differences between economic discussions in academe and those in Washington [Auerbach, 1992]. Among the differences that he noted are (1) the "shorter time horizon, with ideas being raised and discarded with more frequency than the occasional visits to Washington during my academic existence," (2) the important role of lawyers, and (3) the disproportionate time spent on issues that affect only specific taxpayers versus the broader issues that concern an academic economist [ibid., 239].

Other accounts emphasize the ineffectiveness of academic economics in the political process. As James Galbraith reports, "Council of Economic Advisors [CEA] Chairman Murray Weidenbaum, when asked directly what weight of influence, on a scale of one to ten, economists had enjoyed in drafting the original tax program of the [Reagan] administration, replied, "Zero" [1988, 224]. In chronicling the evolution of the Tax Reform Act of 1986 (TRA), Joseph Minarik [1989] found that academic ideas — e.g., taxation of personal expenditures — were quickly overwhelmed by political considerations. The TRA ultimately focused on income taxation and passed because of an unusual confluence of political events — a defiance of the "political law[s] of gravity" — not because of academic arguments. It is now a commonplace that the brief Washington ascendancy of "supply-side" economics was accomplished with no help from academic economists; indeed, it occurred in spite of our efforts. Parsons [1989] argues that editorial writers and journalists like George Gilder and Jude Wanniski made supply-side economics; academic ideas were ineffectual.

Politicians' stories about academic economics are no less disparaging or frustrated. They too will sound familiar. Harry Truman longed for the chimera of certainty — a one-handed economist. Herbert Stein surely spoke for many policymakers when he stated that "[e]conomists do not know very much. . . ." [Hamilton, 1992, 62]. You know the litany. Economists are out of touch, write and speak in incomprehensible tongues, equivocate (the dread two-handedness), condescend, fail to deliver reliable forecasts, and disagree amongst themselves on most everything.

There is something to this. After all, caricatures work only when they capture some recognizable likeness. But these stories go too far, as caricatures are also meant to do. Few would indict the political process as altogether immune from economic ideas or, for that matter, suggest that the knowledge produced by academic economics is irrelevant to politics. Auerbach, for one, did observe some influence of academic ideas on the discussions surrounding the budget. Economists prevent outstandingly stupid ideas from becoming law and also act to ensure that efficiency remains on the agenda. Lee Hamilton, vice-chairman of the Joint Economic Committee of the U.S. Congress, let it be known in the *Journal of Economic Perspectives* that the advice of economists is very much appreciated if pertinent and expressed in clear English [Hamilton, 1992]. And theory predicts that there must be some economic rationale (i.e., a positive marginal product) for the large number of economists who populate federal agencies and for the hundreds of PhD's staffing the World Bank and the IMF, often in influential roles.

So, no, academic economics is not irrelevant. Maynard Keynes was right in his famous valedictory¹ to *The General Theory*; ideas *do* matter, sometimes more than narrow economic or political interest. But ideas do not reside in a conversational vacuum. Their influence depends greatly upon our ability to convey them, and upon our audience's ability to understand them. Professors know that lessons learned are often different from those taught. Government policies rest on economic ideas, almost by definition, but such ideas are not necessarily those of academic economists.²

A rhetorical perspective suggests that ideas require an engaged conversation *and* an understanding of the boundaries and particularities of a given conversation. It is not so much that policymakers are ignorant and unreconstructed rent-seekers or that economists are obscurantist and wholly irrelevant. Rather, they speak different languages. Economists and politicians appear in these unflattering guises only when viewed through the other's conceptual lens. What an economist sees as pork-barrel spending, the politician calls the national interest. The politician's constituent service is viewed by the economist as rent-seeking. The economist's pareto-inefficiency is the politician's redressing of grievance. Clearly, the discourse of economics differs fundamentally from that of politics.

Yet it is more than a matter of speaking "different languages". We suggest that the problems encountered by economists in Washington derive, in part, from miscasting. Outside the academy, economists are cast in roles that they cannot play, or worse, do not recognize as new roles. The blackboard exercises of the seminar room are inappropriate and ineffective in a hearing room. Miscasting occurs, in turn, because academic economics has traditionally given little thought to the relationship between the economist and the policy-making process, i.e., between the production of economic knowledge and its distribution and consumption. Economics, which is now famous for its wide-ranging (some say imperial) theoretical forays, lacks any theory of how academic knowledge affects the everyday world.³ A rhetorical perspective suggests that *how* academic economists see this relationship matters to real world outcomes. One's model of the relationship between academic economics and politics, however implicit, affects one's expectations, one's interpretations, even one's conclusions. Let us elaborate on what we mean by examining some different ways in which economic ideas affect policy.

THE RELATIONSHIP BETWEEN ACADEMIC ECONOMICS AND POLITICS: THREE MODELS.

Alice Rivlin's Presidential address begins with a pleasant "daydream" on the ideal relationship between economist and policymaker:

The dedicated, idealistic young economist . . . as the wise and impartial adviser to the philosopher queen. . . . [T]he adviser presents the best forecasts that can be made . . . She explains the macroeconomic policy options and what is likely to happen if each is undertaken. She elucidates why market solutions are efficient, when markets are likely to fail, and what can be done when this occurs. . . . She represents the best professional judgment of her fellow economists, indicating the major respects in which most economists agree and scrupulously pointing out that the views of some . . . might differ from her own. She remains above the political fray . . . eschewing identification with interest groups or ideological causes. The queen for her part listens carefully and intelligently, asks

thoughtful questions, and weighs the options. She may consult other experts on non-economic aspects of the decisions, but these can be assumed not to be very important. She then makes final decisions — even very hard ones — and sticks to them. [1987, 1]

Clearly, Rivlin's fantastic account is not a realistic description of the interaction between economist and policymaker. Indeed, when this passage is read aloud in public forums, hearty laughter is the typical response. Nonetheless, further conversation generally reveals that economists understand their roles in precisely the idealized form that Rivlin details.

In his account of "The Economics Profession and the Making of Economic Policy" Robert Nelson [1987] elaborates on Rivlin's idealized image, arguing that economists see themselves as "progressive neutral experts." The "progressive neutral expert" is a hardy textbook perennial; the economist presents the policymaker with a menu of options, careful to avoid normative judgments or expressions of preference. This characterization is born of the Enlightenment ideal of scientific mastery by means of reason, the belief that otherwise capricious decisions can be rationalized if only the economist is sufficiently "scientific". In slightly more modern terms, all economic ideas may be classified as either positive or normative, and the normative is to be eschewed when advising the prince.⁴

The model that advanced this role was articulated by Jan Tinbergen in *On the Theory of Economic Policy* [1952]. It portrays economists as wholly disinterested technocrats who, on the basis of econometric models, present the policymaker with a menu of instruments to meet targets that conform with her fully formed preference function over objectives. Though neither the economist nor the policymaker are explicitly modeled, the underlying narrative casts the economist as progressive neutral expert and the policymaker as beneficent public servant. We call this model the *Tinbergen model*. The role it attributes to academic economists is probably the source for much of the confusion and frustration about what economists do and can do in policy-making. The Tinbergen model represents the economist's normative vision; but it is inevitably compromised by a messier, positive reality — one where policy-making is more akin to sausage-making.

There is also an analytical problem with the Tinbergen model, one that any economist will recognize: economists and politicians are presumed to be the only agents who have no interests other than the public interest. James Buchanan, who found his inspiration in Knut Wicksell, was among the first to systematically challenge this incongruity. Citing Wicksell, Buchanan argued that:

Neither the executive nor the legislative body, and even less the deciding majority in the latter, are in reality . . . what the ruling theory tells us they should be. They are not pure organs of the community with no thought other than to promote the common weal. [Buchanan, 1987, 245]

Buchanan proposed abandoning what Henry Aaron has called the "naive view of government" [Aaron, 1989, 1], in favor of an approach that explicitly modeled political agents as rational actors. Politicians (and voters and bureaucrats) behave like economic agents do. They seek their own interest, maximizing votes or power or both. Disinterested economic advice is still sought by policymakers, though to maximize an objective function that is self- rather than public-interested, in what we term the *public choice model*. Public choice theory expanded the domain of economic explanation by explicitly modeling political actors, something the Tinbergen model left exogenous.

The public choice model, however, still casts the economist as the disinterested expert — above the fray, Olympian in self-restraint, objective not partisan, positive not normative, outside the model. Politicians have been admitted to the tent of self-interest, but economists are more modest with our own kind. While politicians appear in most public choice models, economists are virtually unknown. The insights of public choice have helped economists understand, as Henry Aaron has noted, that "[w]hat a political system *can* do becomes at least as important a component of policy advice as what it *should* do" [ibid., 12]. However, if the Tinbergian policymaker has been replaced, the Tinbergian economist lives on: "[m]ost of us leave to others the task of implementing the welfare-increasing actions we have revealed. Having shown the way, we see ourselves as blameless if others lack the wit to follow" [ibid.]. A glance at what advising economists actually *do*, however, quickly reveals that the economist of the Tinbergen and public choice models does not exist.

In reality, academic economists must play many roles, before different audiences. Craufurd Goodwin points out this diversity of functions:⁵

A typical modern economist [engages in] . . . persuasion of economist colleagues of the merit in contributions to the discipline (represented in journal articles, papers presented to conferences, and claims for tenure); persuasion of skeptical students and college administrators of the value of studying the subject; persuasion of patrons, such as foundations and government agencies . . . persuasion of legislators, the media, and a broad lay public that the subject's "answers" to popular questions are worth attending; persuasion of clients that advice based on economic evidence is sound; and persuasion of judges and other arbiters that a client's case is sound while an opponent's is weak. [1988, 210]

Persuasion differs not only "horizontally," as Goodwin sketches, but also "vertically," as within a policy discussion. Economists must first persuade policymakers that the economic approach is useful as a way of seeing the world and for framing decisions. This first step is superfluous in government locales like the Treasury, the Federal Reserve, or the Congressional Budget Office, where economic analysis is not only welcome, it is mandatory. However, at other bureaus like the Interior or the Environmental Protection Agency, economic analysis is not expected, and the first step of persuasion is often never accomplished.

If the economist succeeds, she then may be asked to help the policymaker to form preferences, a second step. "Should I prefer higher output or lower inflation?" seems a legitimate and unsurprising question to ask an economist. As Mark Blaug argues, "economic advice is typically sought, not just to elucidate the possibility function, but also the preference function. The decision maker seeks advice on both ends and means" [1980, 150]. As a third step, the economist may be asked to choose among competing economic models, and only then, having selected, can she play the Tinbergian expert, provided she has great confidence in the chosen model and her audience is comprised of "philosopher-queens." Persuasion by an economist, then, takes many forms. Advocacy requires an interested participation that the textbook economist of the Tinbergen and public choice models cannot muster. The economist's effectiveness depends upon the role required, the audience to be addressed, and the extent of persuasion already accomplished. It is hard to remain above the fray when the fray requires your participation.

Alice Rivlin notes that lawyers, more than economists, accommodate the different demands of different settings. Lawyers have never been squeamish about performing explicitly different roles — defender, prosecutor, barrister, judge, expert, professor, etc. Some economists are equally versatile, filling many of Goodwin's roles, but "economists tend to be uncomfortable in the role of partisans or advocates, preferring to be seen as neutral experts whether we are or not" [Rivlin, 1987, 9]. Why is this? Goodwin suggests that there exists a long-standing identity crisis among economists: is economics a "scientific" discipline pursuing truth or a profession that sells services at market prices? [1988, 207]. Suspicion of and hostility toward organized special interests (like professions) is a hallmark of the economist's *ethos*, an idea with a pedigree that dates at least to Adam Smith, who argued famously:

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. [1976, 145]

To widen the market and to narrow the competition is always the interest of the dealers . . . any new law or regulation which comes from this order, ought to be listened to with great precaution . . . [for] it comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it. [ibid., 267]

Indeed, who would want to be identified with such a group? Better to be a protector of efficiency than to join ranks with the very interests that threaten to subvert optimal (i.e., competitive) outcomes and therefore the wealth of nations. Economists do not want to see themselves as rent-seekers, even as we portray everyone else this way.

Our modern jargon only partly obscures this venerable economic story. Organized interests (and often an opportunist government) conspire to extract rents from an unwary and vulnerable citizenry, whose welfare is understood and protected only by the economist. It is a story that helps to understand economists' self-image and also reminds us that even economists cannot avoid ideology. Efficiency, recall, is a value-laden term. Pareto-optimality is a norm, not a positive "truth". If economists can advocate efficiency, so can we other values. As Nelson notes, economists are "entrepreneurs for efficiency," which sometimes requires that we become "ideological combatants." Therein lies the tension within the economist's identity that Goodwin observed.

If economists are "truth seekers", our research is knowledge for its own sake, and we have no business, indeed no interest in worldly affairs like politics.⁶ But there is another tradition in economics, a desire to make the world a better place. The great liberal political economists of the 18th and 19th centuries embodied these competing traditions. Smith, Mill and Senior, for example, were strong proponents of laissez-faire doctrine, and yet were reformers who wrote to influence men of affairs, the policymakers of their times. All of these political economists recognized that knowledge for its own sake could not be ameliorative and that effective persuasion meant participation in the debates of the day.

To influence policy-making, economists must join, as active participants, the policy-making process. It is this recognition that underlies the *process model*. The process model argues that economists, no less than other agents, are self-interested. The "truth" may well appear in our objective functions, but it need not be the only element. The process model also argues that the interaction between economist and policymaker is messy and conversational, not strictly neutral and objective. Persuasion occurs on several levels. A process-oriented analysis recognizes that policy-making is anything but monolithic. It is scattered and fractious in a way that the Tinbergen model's one economist and one decision maker cannot capture. The process model does not assume that economic knowledge is simply given (like preferences in Neoclassical utility theory), but inquires into the means by which one theory is influential instead of another.

In critiquing economic policy-making, observers typically cite the very problems that a process model perspective wants to investigate. Auerbach, for example, cites the incremental nature of policy-making — a process hallmark. Rivlin proposes reforms to address the institutional frictions that impede good policy-making — mixed government, the segregation of monetary and fiscal policy, the multiplicity of forecasts. Aaron emphasizes the information problems that arise from the fact that the pace of policy-making may well exceed the rate at which economic knowledge develops. Legislation and regulation proceed even when knowledge of their (often interacting) consequences is radically imperfect.

When Henry Aaron said that "[b]ehind every economic analysis meant to influence policy lies an explicit view of government" [1989, 12], he was half right. We argue that behind every economic analysis meant to influence policy there also lies an explicit view of the advising economist, i.e., of how economic ideas affect policy

decisions. Our models of how economic ideas affect political decisions help determine the behavior of advising economists, which, in turn, influences their rhetorical effectiveness, which is often decisive in bringing about knowledge diffusion. Like the agents in our models, what economists know of their affairs affects how we conduct our affairs.

A rhetorical perspective helps illuminate the sources of the rhetorical gap between economists and politicians, and a rhetorical self-awareness may even make economists better persuaders. Rivlin suggests, for example, that “[e]conomists might increase their usefulness to the policy process if they made clear at any given moment which role they were playing” [1987, 12]. But a rhetorical perspective also leads us to appreciate the difficulties of bridging that rhetorical gap.

ACADEMIC VS. EVERYDAY ECONOMICS OR, WHY DON'T POLICYMAKERS LISTEN?

The existence of a rhetorical divide is not in dispute. We have offered some possible explanations for its persistence. A harder question is, what to do about it? How can the economics of the academy be joined with the economics of everywhere else (policymakers, journalists, ordinary people, etc.)?

An important traditional explanation argues that all we need do is to bridge the gap. In this account academic and everyday economics are fundamentally alike, with the difference that everyday economics is *ersatz* economics, that is, a simplistic or shabby or otherwise watered-down translation of the “truths” found in academic economics. Call this the *translation thesis*. In this story, academic or “greek letter”⁸ economics is only procedurally or stylistically different from everyday (“roman-letter”) economics.

The translation thesis holds that everyday and academic economics are commensurate. Substantively, academic and everyday economic discourse share similar ends — to establish the truth about the economy and its actors, for example— even if this similarity may be obscured by differences in language used. If this thesis is correct, then greek-letter economics can be rendered into its roman-letter counterpart *with no loss of content*. As Representative Hamilton suggested, all economists must do to reach policymakers is speak in plain English.

If this is so, there should be a brisk market for translation. Individuals who are fluent in both greek-letter and everyday languages should command high prices. Since academic and everyday economics share the same ends, but speak different languages, the task is simply to locate academics willing to shed their highfalutin talk and use plain language. Alternatively, policymakers could acquire enough training to master our intellectual tools and become comfortable in both languages. In reality, of course, the market for translation is surprisingly thin. Academics who dabble in everyday economics (e.g., writing newspaper columns) risk being vilified as “unserious,” regardless of their academic accomplishments. And journalists or politicians who bother to understand even the rudiments of academic theory risk the label of “irrelevant” or “inaccessible.”⁹ Perhaps this explains the thinness of translation markets.

But if translation is possible, why is there a gap at all? Too often, proponents of the translation thesis resort to rounding up the usual suspects: stupidity or laziness. The argument from stupidity makes politicians either unwilling (lazy) or unable (stupid) to grasp academic theorizing, even when cast in everyday language. They just don't get it. This explanation is problematic, however. For unless one argues that academic research is not worth the candle, rational agents should recognize the value of sophistication in economic matters, and prudently invest in economic knowledge.

It is more generous and more plausible to argue that time and other institutional constraints prevent the translation market from smooth functioning. There is a market for translation, but it is imperfect owing to the lack of a perfect price mechanism and the multitude of institutional constraints already cited. The argument from institutional constraints may be more "realistic", but it proposes reform precisely because it believes that translation is ultimately possible. If the policy-making process could be rationalized, perhaps by enacting the reforms of distinguished experts, then the translation market will not fail and economists and politicians will understand each other perfectly.

But what if proper translation is not possible, even under ideal assumptions? In this case academic and everyday economics constitute fundamentally different ways of talking about the economy, without the possibility of straightforward translation. The two discourses are simply different, or, to use Thomas Kuhn's term, they are "incommensurable" [1970]. They may be related in trivial ways (e.g., they both make statements about the economy), but no translation is possible without doing injustice to either mode of discourse. Call this the *difference thesis*. Economists and politicians see the world differently, period. They each start with a unique conceptual apparatus that precludes perfect translation. In short, plain English is a necessary but not a sufficient condition for understanding.

If incommensurable, the key issue is whether difference matters: does the academic way of talking about efficiency, for example, matter to policy-making, and vice versa. Efficiency is an important concept to economics, but may be inconsequential to political discourse. We distinguish two species of difference. The *inconsequential-difference thesis* states that academic economic discourse serves purposes different from those of everyday economic discourse, but that this divergence is inconsequential. That is, neither discourse influences the other in ways that matter for their respective ends. The two are substantively different but in non-instrumental fashion, i.e., without consequences for interpretation of the economy or the science of economics. The market for translation, even if it were possible, would not exist: academic and everyday economics would happily remain strangers. People can get along in the world just as well with or without academic economics. Clearly, academic economists have different purposes, but so what? — their talk is inconsequential.

The *consequential-difference thesis*, on the other hand, maintains the incommensurability of academic and everyday economics and further proposes the idea that incommensurability has consequences for each domain's respective objectives;

that is, difference matters. According to this thesis, academic research does affect politicians' concerns, but the rhetorical divide cannot be bridged by more and better translation. Despite (or perhaps because of) their incommensurability, the greek-letter conversation influences politics, and the political conversation influences academic economics. In short, we affect each other in profound ways, but neither economists nor politicians know how.

To illustrate some of these points more concretely, we turn our attention to the discourse surrounding the capital-gains debate of the mid-1980s.

THE CASE OF CAPITAL GAINS POLICY

Among the many changes enacted in the Tax Reform Act of 1986 (TRA), none received more subsequent attention, nor possibly affected budget politics more than the decision to tax capital gains at the same rate as other income. After a short hiatus of two years following passage of the Act in 1986, taxation of capital gains was singled out by presidential candidate George Bush in his campaign as a feature of the tax code he would propose to change. True to his campaign pledge, President Bush submitted a proposal to cut the effective tax rate on capital gains in his first budget. While initially downplayed as "dead on arrival," the proposal attracted a surprising burst of support in the Congress in 1989. Though the effort to restore some form of capital gains preference failed in 1989, the issue reemerged, only to fail again in 1990 and in 1991.

Along the way, the spirited, frequently contentious debate about the tax treatment of capital gains contributed significantly to budget gridlock between the Administration and Congress. This was evident in the debate surrounding the 1990 Budget Agreement, which stalled several times, in no small measure because of heated disagreements about the tax treatment of capital gains.

How did economic theory and evidence inform this debate? Was the debate cast in the neutral, expert terms implied by the Tinbergen model? If not, why not? What does the answer to this question tell us about the interplay between economic theory and the policy process? What lessons may be learned by economists who want their ideas to influence the policy process?

THE DEBATE IN THEORY: THE TINBERGEN PARADIGM

We first consider how the 1980s capital gains debate would have been framed if cast in terms of Tinbergen's model of policy-making. As noted by Auten and Cordes [1991], the policy debate about cutting taxes on capital gains revolved around three questions: (1) Would cutting taxes on capital gains increase or decrease the federal budget deficit? (2) Would cutting taxes on capital gains make the tax system more or less fair? and (3) Would cutting taxes on capital gains foster economic growth? In terms of targets and instruments, the "targets" at issue would therefore seem to be (1) revenue, (2) distributional equity, and (3) economic growth, and the "policy instrument" was the tax rate on capital gains.

Policy Targets and Constraints

A well-known property of the targets-instruments framework is the existence of trade-offs among different targets when the number of targets exceeds the number of instruments. This issue was recognized, though only implicitly, in the debate. Proponents of cutting taxes on capital gains argued that cuts would (1) significantly spur economic growth, (2) reduce rather than increase the federal deficit, and (3) benefit taxpayers of modest means as well as the well-to-do. Opponents countered that cutting taxes on capital gains would (1) have little or no positive effect on economic growth, (2) would not reduce the federal deficit, and most likely would increase it, and (3) would concentrate benefits on wealthy taxpayers. With respect to the Tinbergen model, then, the debate about cutting capital gains taxes could be cast in the following terms:

- determine whether a change in the instrument — the tax rate on capital gains — positively affects a particular target — economic growth;

subject to the constraints that changing the value of the instrument:

- does not increase the federal budget deficit,
- does not unduly benefit wealthy taxpayers.

A Model

Given the above objectives and constraints, the task facing the advising economist would be to use available economic theory and evidence to assess whether cutting taxes on capital gains met the objective, while satisfying the constraints. To make such an assessment, our Tinbergian economist-adviser would have relied on some version of an economic model whose main features are summarized by equations (1) - (5).¹⁰

$$(1) \quad Y = y(L, K)$$

$$(2) \quad dK = I = S$$

$$(3) \quad S = S_p + S_G$$

$$(4) \quad S_p = S_p[Y, r(t_G)]$$

$$(5) \quad S_G = [G - T(Y, t_G)]$$

where y is real aggregate income (as measured by gross national product or gross domestic product), L is aggregate labor supply, K is the aggregate capital stock, dK is the change in the stock of capital, I is aggregate private investment, S is national

saving, S_p is private saving, S_g is the government deficit/surplus, r is the after-tax return to saving, G , is government spending, T is tax revenue, and t_c is the tax rate on capital gains.

Equations (1) - (5) embody the following propositions about the link between the "instrument" (the capital gains tax rate, t_c) and the "target" (economic growth, represented by real income, y).

1. The real income of an economy depends on its productive capacity, as represented by the amount of labor and capital available for production (equation (1)).
2. The amount of investment and saving in the economy determines the amount of capital available for production (equation (2)).
3. The amount of total saving equals the sum of private saving plus the government deficit or surplus (equation (3)).
4. The amount of private saving depends, *inter alia*, on the after tax return, r , received by savers, which, in turn, depends in part on the tax rate on capital gains, t_c (equation (4)).
5. The government surplus or deficit depends, in part, on tax revenue, which in turn depends, in part, on the tax rate on capital gains, t_c (equation (5)).

Parameters of Interest

One virtue of the simple policy model we have sketched is that it reduces the relatively complex problem of determining the economic effects of cutting taxes on capital gains to the seemingly more tractable one of determining the empirical magnitudes of a handful of key parameters, as shown by equation (6), which demonstrates the ways in which the instrument, t_c , can ultimately affect the target y .

$$(6) \quad \partial y / \partial t_c = (\partial y / \partial S_p)(\partial S_p / \partial r)(\partial r / \partial t_c) + (\partial T / \partial t_c)$$

In terms of the Tinbergen framework, equation (6) implies that the efficacy of the instrument, t_c , with respect to the overall objective depends on (1) the sensitivity of real income/output to changes in saving ($\partial y / \partial S_p$), (2) the sensitivity of private saving to the after-tax return ($\partial S_p / \partial r$), (3) the sensitivity of the after-tax return to saving to the tax rate on capital gains ($\partial r / \partial t_c$), and (4) the sensitivity of income tax revenue to the tax rate on capital gains ($\partial T / \partial t_c$).

THE DEBATE IN PRACTICE

Was the capital gains debate conducted in terms consistent with this framework of rational policy-making? Did economists persuade policymakers that the efficacy of capital gains tax cuts depended upon a few key parameters, which one might estimate empirically? The answer is, yes and no.

Perhaps not surprisingly, *economists* at places such as the Congressional Budget Office (CBO), the Congressional Research Service (CRS), the Council of Economic Advisers (CEA), the Joint Committee on Taxation, the Treasury Department, framed the issues in ways that would be recognizable in the above framework. Considerable professional effort was devoted to obtaining and debating econometric estimates of the revenue elasticity of changes in the tax rate on capital gains ($\partial T / \partial t_c$), to identifying "plausible" values of the elasticity of private saving to the after-tax return ($\partial S_p / \partial r$), and to assessing how much a cut in the capital gains tax would affect the after-tax return to saving ($\partial r / \partial t_c$).

The question, however, is not whether economists embraced a Tinbergen-like framework in debating the merits of cutting the capital gains tax among themselves. Indeed one might be surprised if they did not. Rather, the question is whether family discussions among economists cut any ice with those uninitiated into our discourse. Does the Tinbergen model accurately depict the way in which economic conclusions were communicated to policymakers and affected their decisions?

In a trivial sense, yes. As Henry Aaron [1989] has noted, any critic or supporter of a particular (tax) proposal who cannot marshal a study is not taken seriously, as was true in the capital gains debate. Policymakers required economic research to buy credibility, and therefore, economic research demonstrating the efficacy of cutting capital gains taxes as a policy instrument, or the lack thereof, was in demand. The CEA prepared a study of the effects of cutting taxes on capital gains on economic growth and the deficit, and the CBO and the CRS produced similar studies for the congressional leadership.

Yet, we are hard-pressed to find much evidence of a Tinbergen-like discourse before policymakers, in which scientific evidence about a capital gains tax cut was received from neutral experts, carefully weighed, and acted upon. Clearly, policymakers found supporting studies useful, if only as another weapon in their rhetorical arsenal. Both the President and the Congressional leadership regularly cited economic studies to support or undermine the claim that a capital gains tax cut would spur economic growth and not increase the deficit. The central question, however, is: were policymakers persuaded to adopt their positions by the economic reasoning found in those studies (and in economists' presentation of them), or did the studies merely shore up positions already established independent of the economic analysis? And, if policymakers had already reached positions *ex ante*, what economic ideas (remembering Keynes), if any, determined those priors? The answers, not surprisingly, are unclear, though some evidence is suggestive.

ACADEMIC AND EVERYDAY ECONOMICS REVISITED

It seems likely that the Tinbergen model does not capture the character of the capital gains debate. We know of no accounts where policymakers wrestled with the relative magnitudes of estimated elasticities, interrogating economists until the economic "truth" was teased out of the econometrics. The Tinbergen model will not admit policymakers with already established priors, a distinct possibility, nor can it even conceive of policymakers who are less than wholly public-spirited. In persuading the policymaker, economic research is decisive in the Tinbergen model. The public choice model is likewise deficient. It argues it may be that policymakers *must* have priors, as dictated by their self-interested motive to maximize the likelihood of reelection. Economic research is never decisive, nor meaningfully persuasive, except to the extent it provides a useful fig leaf for existing priors. Policymakers can never do the right thing, except by coincidence, and therefore academic ideas can affect policy-making only by accident. The process model argues that reality lies somewhere in between. Ideology matters, as do political exigencies, and academic economic arguments may well persuade in *some* situations.

It seems clear that time and other institutional constraints operated to mitigate the efficacy of academic ideas. Politicians have short time-horizons, with a built-in bias for action and hence results over analysis. Absent a sudden increase in economic literacy, these constraints make translation of academic ideas into everyday terms less likely, even if attainable. But what if translation is not merely costly, but unattainable? Is there evidence of rhetorical differences between academic and everyday economics that makes the difference thesis plausible?

Differences in Metaphors and Narratives

We have described how everyday economics and academic economics frame economic reality in different ways — the rhetorical gap — and we have argued that a gap may arise from an incommensurability between economic and political discourses. The capital gains debate offers several examples.

Academic economists tend to rely on formal, highly stylized metaphors. *Homo economicus*, for example, is a character that is unrecognizable to the everyday realm, but he is our saver and our investor. The life-cycle saver mechanically responds to changes in the after-tax return in opposite and potentially offsetting ways called income and substitution effects. The investor calculates after-tax cost risk and returns by employing a formal portfolio choice model. In this world, a capital gains tax cut will affect a firm's cost of capital only if it encourages private saving. Magnitudes matter too. The academic economist is likely to wonder how a tax cut that affects only \$20-30 billion of capital income can profoundly influence a \$5 trillion economy.

Contrast this academic version of economic reality with a popular species of what we have called everyday economics. This is the "partisans of capital" variant, which celebrates the entrepreneur and the power of "free" capital. In this world, the actors are not calculating life-cycle savers and investors, but flesh and blood inves-

tors who take "irrational" risks. It is a world of drama and moral consequences, complete with heroes — the entrepreneur struggling in her garage to create the next Microsoft — and villains — the wealthy investor investing in blue-chip stocks, reaping windfall gains. Capital is not an "input" to a production "function"; it is the very stuff of economic progress. In everyday economics, the "whole" can be more than the sum of its parts, as revealed in the remarks of an entrepreneur who, in referring to capital gains, observed that "this *tiny segment* of a huge total capital market is *the lubricant of entrepreneurship and technological progress*" [Landau, 1986, emphasis added].¹¹

In everyday economics, "entrepreneurs" are the heroes; in (mainstream) academic economics, savers drive outcomes. In the academic narrative, which relies on a continuous-time Neoclassical model, it is the life-cycle saver who decides how much to save and where to put her saving, given a menu of investments that includes assets whose total return is comprised in whole or in part of capital gains. To this saver, assets which yield capital gains are merely one of many ways by which one can transform current income into future consumption. Savings invested in activities that yield capital gains differ from other savings only in degree, not in kind. Therefore, aside from risk differentials, a dollar invested in dividend-paying stock is not inherently different from a dollar invested in a start-up venture. In academic models, the life-cycle saver rules. Entrepreneurs do not even exist; they are subsumed under "demanders of capital."

In everyday economics, by contrast, the saver takes a back seat to the heroic entrepreneur, who is willing to risk secure, salaried employment to found her own business. Capital gains are a just reward for creating new opportunities and new economic wealth, not merely a means of creating future consumption out of current income. Savers play a role in this account by providing "seed capital" to new ventures in exchange for payoffs that are lumpy rather than continuous, i.e., different in kind from other more regular forms of capital income, such as dividends and interest.

These different ways of characterizing economic reality have important consequences for the debate about capital gains. Putting life-cycle savers at center stage provides a rhetorical foundation for arguments that emphasize the *similarity* between capital gains and other uses of saving. For example, it is best to tax all capital income broadly and at low rates. If the entrepreneur is the protagonist, then arguments about capital gains will emphasize the *differences* between capital gains and other income. For example, a capital gains differential should be maintained as matter of policy, even if doing so means taxing other forms of income at higher rates.¹² The two quotes below capture some of this rhetorical difference. The first quote, from a CBO report, reflects the academic perspective [Congressional Budget Office, 1990, 2]; the second, from a venture capitalist, reflects the everyday perspective [Ruhm, 1986]:

The more that a capital gains tax raises the return to savers and lowers the cost of capital to business, and the more that saving and investment respond to such changes, the more likely it is that such a tax cut will spur saving and investment and raise GNP. . . . Lower capital gains taxes would favor assets that pay off in the form of capital gains. This would have both good and bad effects on the mix of investment Thus, it is uncertain whether cutting capital gains taxes would cause capital to be allocated more efficiently.

...it is the results of the most successful (venture capital) investments that most greatly benefit our nation! We badly need a strong incentive to create those successes! This strong incentive is presently provided by the effects of the capital gains differential on the value of entrepreneurs' and their associates' stock interests in the companies they are creating. The capital becomes available for the growth of their companies, and the market wants the stock to sell. This is the goose that lays the golden eggs....Society at large further benefits from the capital gains tax differential through the availability to its imaginative, energetic young people of jobs with growing companies of all sizes, as opposed to jobs only with large or giant companies in which the individual from time to time gets lost completely.

Incommensurability and the Role of Economic Research

When everyday economics and academic economics frame economic reality differently, policymakers will naturally tend to judge economic research not in its terms, but in light of their own everyday knowledge. If nothing else, incommensurability makes one look homeward. This has several consequences. One is that if the metaphors and narratives of academic economics are not well understood, disagreement among economists about *implications or parameters* of a particular model are easily misconstrued by the non-economist as fundamental disagreement about *the value of the underlying model itself*. Evidentiary disputes over the magnitude of the interest elasticity of savings does not mean that academic models are useless, but neither are they sufficiently decisive for policymakers. This in turn makes it easier for consumers of economic research to use it "forensically", in which case the results matter more than the analysis itself. Even if policymakers are not inclined to use academic research forensically, i.e., to shore up existing priors, the price of academic research may be too high. That is, the costs of proper translation, even if possible, may exceed the expected benefits to the policymaker.

IMPLICATIONS FOR POLICY

What preliminary lessons, then, emerge from thinking about the economic policy process rhetorically? One is that the oft-noted preference of policymakers for results over analysis may arise for reasons going beyond the simple press of time or ideology. As long as academic and everyday economics are incommensurate, practitioners of the latter will tend to assess the value of academic economics in terms of "believability" of results rather than nature of the analysis. A sobering corollary is that the credibility and impact of academic research will depend less on the "quality" of the analysis and more on whether the results can be rationalized and explained in terms of everyday economics. Persuasion takes many forms, as we have seen, and it may be that academics must sell sizzle as well as steak.

Another implication is that the effects of economic research on the policy process can be rather ephemeral. This is because research results themselves are often short-lived — yesterday's breakthrough is passé today — and because the policymaker's demand for economic research depends on other elements in her objective function. Because everyday economics is not systematic in construction, practitioners are better able to accommodate competing claims, like those that arise from political considerations. Thus, consumers of academic economic research will accept its conclusions in some settings, but not in others. We suspect, for example, that academic economists who were skeptical of the economic benefits of cutting capital gains taxes in the 1980s would greet the current administration's proposals for "targeted" cuts in capital gains with similar skepticism. We doubt that the same can be said for many policymakers who concurred with the skeptical studies prepared by economists in the 1980s. This need not imply that policymakers are mendacious or that economists never are self-interested, rather, to borrow an expression, that policymakers make decisions with more targets and fewer instruments than do their academic advisors.

A further consequence of the rhetorical divide between academic and everyday economics is that differences among economists about the implications of a shared model — e.g., disagreement about the size of the interest elasticity of saving, or about the revenue elasticity of the tax rate on capital gains — may be seen by everyday economics as a fundamental disagreement about how the economy works. Such perceptions tend to reinforce and magnify political decision makers' views of economists as "quarrelsome folks who...cannot agree, cannot express themselves clearly, and have strong ideological biases..." [Rivlin, 1987, 5] which can undermine the economist's effectiveness in the policy process. Finally, the rhetorical perspective also implies that translating the results of academic research into "plain English" is a necessary, but not a sufficient condition for bridging the rhetorical gap. Explaining the life-cycle model of saving in plain language is useful, but doing so will not in and of itself induce policymakers to adopt this model as the way to think about incentives for savings.

IMPLICATIONS FOR ECONOMISTS

If the rhetorical gap between academic and everyday economics has consequences for how economic knowledge is actually used in the policy process, what can or should economists do in response? The most direct, but probably also least feasible solution has been proposed by Alice Rivlin who suggests that economists devote efforts to expanding the numbers of people who are well-versed in the discourse of academic economics by "increasing the basic economic literacy of the public, the media, and the political community" [1987, 8]. Get everyone up to speed, and we can minimize misunderstandings.

This is a noble idea. But while increased economic literacy would narrow the rhetorical gap, a widespread outbreak of "economic literacy" seems unlikely. After all, rational actors should already have recognized the returns to economic sophistication and invested accordingly. Maybe the costs of greater economic knowledge — tuition expense and years of hard work — do not justify the benefits, which are largely external. Perhaps we can see economic knowledge as a public good, where policymakers and others are tempted to free ride. But millions of students have been through our classrooms, and economists have introduced thousands of journalists, judges, politicians and others to economic principles. Few convert. Most leave the classroom and return to the everyday fold. Everyday economics is most unyielding.

This is not to say that economists have no influence on public discourse. On the contrary, many of our colleagues populate the highest reaches of government and business and university administration. We know that our advice is sought out and we are well paid for our expert opinion in courts of law and in private settings. We might even say economists are influential, even if economics is not. But, we do not know for sure. We have no systematic knowledge of how academic ideas about economics affect the world outside the academy. This is a strange state of affairs if one subscribes to the conventional justification of academic research, which is to influence the thinking and actions of others.

This paper has offered a preliminary strategy — investigate the influence of academic ideas by considering the interaction between academia and elsewhere as a process, with special attention to rhetorical barriers which may hinder communication. Implicit in our approach is the notion that economists can profit by taking seriously the everyday rhetoric of the agents we seek to understand. Watch what agents do, not what we say they do, and we may come to understand why the everyday world seeks refuge in everyday economics rather than listen to us.

NOTES

1. "[T]he ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so that the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest. But, soon or late, it is ideas, not vested interests, which are dangerous for good or evil" [Keynes, 1953, 383-4].
2. Defined broadly, any idea that concerns economic matters is an economic idea. An investor who believes that World Series outcomes affect stock prices is expressing an economic idea. Mercantilist notions are still popular ideas, though they have no currency in academia.
3. Ours is not a novel observation. Craufurd Goodwin [1972] makes a strong case for the theoretical returns to studying the relationship between economic theory and society.
4. David Colander reminds us that Neville Keynes's famous taxonomy proposed not two but three categories: normative economics, positive economics, and the art of economics. Says Colander: "The art of economics is applied economics. It relates the lessons learned in positive economics to the normative goals learned in normative economics." And, "Keynes argued that economists' failure to distinguish the art of economics as a separate branch from positive and normative economics would lead to serious problems . . . he has turned out to be clairvoyant." [Colander, 1992, 192].
5. Goodwin's taxonomy of economic roles is (1) philosopher (read: scholar), (2) priest (read: practitioner), and (3) hired gun (read: interpreter).
6. This view may be found, for example, among economists friendly to "new Chicago" economics. Robert Lucas, a distinguished proponent, says: "One reporter once asked me what I'd do if I were on the Council [of Economic Advisors]. I told him that I would resign." [Klamer, 1983, 54].
7. The ideas in this section are due to Klamer and Leonard [1992].
8. "Greek letter economics" is a term coined by Paul Krugman [1990] in his primer on economics for non-economists — an attempt to make "sophisticated" economics intelligible to the non-specialist.
9. Jeff Greenfield, a television journalist, has said that "Economics was once the blind date of journalism. It was better than staying home, but not much" [Miller, 1989, 36].
10. The "model" described in these equations is hardly complete. It is meant to capture the essential features of the type of model that economists might use to frame the policy issue.
11. Ralph Landau is a PhD chemist who has founded two highly successful businesses, and who, like another entrepreneur-scientist, George Hatsopoulos, has taken a keen interest in what we have termed academic economics.
12. Jack Kemp is a proponent of this view. Kemp, though a "tax cutter", supported President Clinton's initiative to raise marginal income tax rates precisely because it would reestablish his main desiderata, preferential rates for taxation of capital gains.

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