

Known unknowns: competition, discovery and the limitations of CBA

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Some basic economics

- Sources of efficiency gain:
 - Allocative; productive/cost, dynamic.
- Which matters most for economic progress?
 - Dynamic, by a long mile.
- Where is the comparative advantage of competition (relative to central planning, command and control, centrally determined prices, etc.) greatest?
 - Dynamic, also by a long mile.
- Why so?
- It's about information, stupid.

Markets as information systems

- Many key economic issues are to do with discovery and use of new information.
- Competitive markets are the most effective social institutions we have yet found for discovering, processing, transmitting, and using new information – all economically relevant info, not just R&D etc. – in ways that promote economic progress.
- Eg. They promote both specialisation (division of labour) and diversity in information discovery, storage, retrieval and use (look at the back of a £20 note and replace A. Smith's pin manufacture example by information activities).
- Competitive markets are at their best, relative to the alternatives, in dealing with unknowns, not in delivering 'desired' outcomes on the basis of today's knowns.

Immediate implications

- The chief advantages of competition are very difficult to value. What is it worth to know a bit more about what is currently unknown?
- The significance of the advantages flows from (a) the (dominant) potential contribution of dynamic efficiencies (learning) to economic progress and (b) the starring role of competition in the realisation of that potential.
- It is therefore wrong to think of the benefits of competition as a qualitative 'add-on' to a CBA. That would be to fail to spot the elephant in the room.
- Discovery will be more effective if the existing boundaries (known/unknown) are assessed realistically. Beware the 'pretence of knowledge' – such pretence is likely to be very costly.

Obstacles to progress: cognitive and situational biases in the face of the unknown

- Prevalence of heuristics in decision making, but these introduce vulnerability to systematic biases, at both the individual and social/institutional levels. Examples (from a long list) include:
 - Attribution bias.
 - Causal oversimplification (cf J. Schumpeter on the ‘Ricardian Vice’).
 - Over-confidence/expert bias (over-estimation of the knowns).
 - Confirmation bias.
 - Justification bias
- Within government, political pressures for a ‘narrative’ also tend to promote bullshit (roughly, “indifference to truth” – see Prof Harry Frankfurt, *On Bullshit*, Princeton University Press).
- CBA, as a form of unaudited economic accounting is particularly prone to these biases. There are no substantive professional correctives or checks and balances.
- The currently dominant approach to regulatory impact assessment tends to strengthen, rather than counteract, the various biases.

Samizdat 1

- *“Looking at the 300 plus examples of regulatory measures ... I find it hard to find any where CBA would be feasible or appropriate. ... Departments now are increasingly seeking ways to provide some analytical basis for decision making where conventional CBA cannot cope, because it is impossible to express all the important factors in monetary terms.”* Wise old economist, by email.
- *“This is how it must have been in the Soviet Union. We are all going through the motions, but none of us believe.”* (whispered by a wise young economist, sometime, somewhere in Westminster, as a decision that would likely waste a couple of hundred million was being made).

Samizdat 2

- *“I do not ask that before economists are turned out from the graduate school assembly line bearing the Ph.D. as a stamp of completion of the training process, they may be required to have shown that they are finished scholars as well as finished economists. True scholarship is always an unfinished and an unfinishable process. Scholarship is a commitment to the pursuit of knowledge and understanding, but it can never provide guarantees that these have been attained. A great part of true learning, in fact, takes the form of negative knowledge, of increasing awareness of the range and depth of our unconquered ignorance, and it is one of the major virtues of scholarship that only by means of it, one's own or someone else's, can one know when it is safe to dispense with it. Learned ignorance, therefore, is often praiseworthy, although ignorant learning, about which I will say something later, never is.”* (Jacob Viner, at Brown University, 1950).

Samizdat 3

- *“If anyone actually knew everything that economic theory designated as “data”, competition would ... be a highly wasteful method of securing adjustment to these facts.”*
- *“... it is useful to recall that wherever we make use of competition, this can only be justified by our not knowing the essential circumstances that determine the behaviour of the competitors.”*
- *“I wish now to consider competition systematically as a procedure for discovering facts which, if the procedure did not exist, would remain unknown or at least would not be used.”*

Samizdat 4

- *“... competition is important only because and insofar as its outcomes are unpredictable and on the whole different from those that anyone would have been able to consciously strive for; and ... its salutary effects must manifest themselves by frustrating certain intentions and disappointing certain expectations.”*
- *“When ... we do not know in advance the facts we wish to discover with the help of competition, we are also unable to determine how effectively competition leads to the discovery of all the relevant circumstances that could have been discovered. All that can be empirically verified is that societies making use of competition for this purpose realize this outcome to a greater extent than do others – a question which, it seems to me, the history of civilization answers emphatically in the affirmative.”*
(F.A. Hayek, *Competition as a discovery procedure*)

Samizdat 5

- A short economics test:

At a recent conference on regulatory impact assessment, an economist presented estimates of differences in the cost of saving a human life associated with a range of different, government-funded safety measures. The cost differences were large, and the presenter argued that this showed the potential value of a “more economic approach” to resource allocation. However, very similar patterns of differences, and very similar arguments, were being presented at economics seminars over thirty years ago, in the 1970s. Does this evidence point to (a) the enduring ignorance of non economists, (b) total incompetence in convincing policy makers of the value of a “more economic approach”, (c) the economists concerned were/are missing something? Explain your answer.

(Bottle of decent wine for the best answer, to cover email).