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Shadows Over Chicagoans. A Guide to the Chicago School in Economics

The Elgar Companion to the Chicago School of Economics

by **Ross B. Emmett**

Edward Elgar, 2010.

The Chicago school is one of the most prominent schools in twentieth century economics. If not for others, this reason is sufficient to call attention to a book on the School from a famous publisher. The merits and shortcomings of the book will be discussed after a brief description of its content.

The book is medium in size and it was for a long time in preparation, since "the late 1990s", as the editor witnesses. More time elapsed for preparation of a book than it is usual sometimes feeds its quality and consistency and sometimes their reverses, indicating that there were some problems in completing the task. Besides a brief Emmett's "Introduction" (pp. 1-4), the book basically consists in two parts. Part one consists in essays on some topics that relate the School to other theoretical orientations or that represent some leading themes of interest for the Chicago authors. Part two contains profiles of 19 of the Chicago school authors.

Part one begins with Daniel Hammond's study "The development of post-war Chicago price theory" (pp. 7-24) that summarizes the main facts and general convictions of the post-war Chicago school. The core of the study is on some differences between Milton Friedman and George Stigler in understanding the price theory and its elements. Hammond well discusses their differences in the conceptualization of preferences, utility and marginal utility. He aptly concludes that the "Chicago price theory tends to be more concrete, less abstract, more pragmatic, less speculative…" (p. 10) than are either neoclassic and its current mainstream, but this is said without any further elaboration and comparison between Chicagoans and the mainstream neoclassic. There was a space for that, because the study contains two pages on Friedman's intellectual development and a page of remarks on the Law school; both are not necessary at this place, i.e. they should not belong to such a study on price theory. All in all, Hammond's study is not a quite satisfactory start for this collection.

The introductory study is followed by 14 essays and studies on the relationships of the Chicago school and other schools, orientations and economists (institutionalism, law & economics, Virginia school, liberalism, Adam Smith), some of the Chicago school topics (monetarism, labor market, welfare, regulation). This part also includes essays on some important contributions by the Chicago authors, like on

Friedman's *A monetary history of the USA*..., Frank Knight's *Economic organization*, and Becker's *Human capital*. There is no place to analyze these contributions, but some articles here belong to the best ones in this collection.

Part two consists in 19 shorter articles on some of the Chicago authors, sorted out alphabetically from Gary Becker to Jacob Viner. The selection is arranged in a puzzling way. For example, there is an essay on Laurence Laughlin, but none about another important author of the first generation of the Chicago economists from 1890s like Thorstein Veblen.[1] There is an essay on Deirdre McCloskey, but none about Robert Lucas or Friedman. Friedman is compensated by two studies on his monetary theory in the Part I of the book, while Lucas is not. Besides, there are some other Friedman's contributions, like permanent income theory, theories of inflation, unemployment, "positive economics", education, etc. There are also essays on some authors that were negligent at the time when they lived and worked, and that are now completely forgotten (for example Margaret Reid, Gregg Lewis, Sherwin Rosen, Bert Hoselitz or Albert Rees) but no essays on some from those who coined the "Chicago school" or about those who continued the School after Friedman and Stigler, like Sam Peltzman or Harold Demsetz. If the criterion is who thought at the economics department, Oskar Lange (he thought at the Department 1938-1945) should be in, while Richard Posner should be out, because he thought at the Law school. If theoretical relevance is the criterion, a half of the list should be out, with Friedman, Lucas, Peltzman and Demsetz being in. If the theoretical orientation of the core Chicagoans is the criterion, the list should include names like Friedman, Stigler, Becker, Lucas, Peltzman. This absence or mixture of criteria can hardly be explained. It is apparent that the criteria are messy.

In his brief introduction Emmett tries to depict the Chicago school as a practical rather than theoretical. Its approach to economics he calls "policy science" (p. 1) or "applied policy science" (p. 1, p. 3). If this means that the Chicago authors did not wanted to isolate themselves into an ivory tower and that they did not wanted to ignore practical problems, this may be true. But if this would say that daily problems dominated the theory, this would be a heavy mistake. Even those who disagree with the Chicagoans would say that they were one of the most important theoretical schools in 20th century economics. In order to support his view Emmett suggests in his introduction that the "Chicago boys" a) have nearly ignored price theory, b) that differences to other schools are trivial and c) that methodology is rather poor. Nothing of the three fits to facts.

Ad a) The first article after Emmett's introduction deals exactly with the Chicago price theory, the core of any economics' theory. The Chicago authors probably had not left anything unique like Alfred Marshalls's *Principles of economics*, but they left a thousands of pages on the main questions on price theory and on economics' methodology. This is produced merely by Stigler and Friedman, but also by some others. Price theory is the most important part of economics, but Stigler believed that it is the only in economics that matters. He used to say that there is only one good economics – economics of relative prices. About the application of the

[1] Although both worked on the economics department in Chicago from 1890s on, neither Laughlin nor Veblen belong to the Chicago school proper, which is a phenomenon from 1940s to 1980s.

price theory outside the economic market not to speak at all, because this extension of the price theory belongs to the most typical artifacts of the School, what is well illustrated in studies of Becker and others. So, Chicagoans are misrepresented here in what concerns price theory.

Ad b) It is hardly to conceive the relaxation with which Emmett tries to depict the merit of the Chicago school. "The essays in this volume discuss various dimensions of the nature, development, and extensions of the Chicago brand, often known as the Chicago School of Economics. The term 'School' is used here in a 'positive' sense; to indicate that a common set of assumptions – methodological and theoretical – about the discipline was developed by the economists at the University of Chicago, who sought through their teaching and research to enrich, extend and promote their vision of economic science. In this sense, one could speak equally of a Chicago School, a Cambridge (UK) School, a Wisconsin School, perhaps even a Cambridge (MA) School, with each of these schools … adopting different methodological and theoretical assumptions and promoting a different perspective of economic science". (Emmett, p. 1.) Even if it is from the editor, it is too much. What should be the criteria of comparison if Richard T. Ely and John R. Commons (to take the two most prominent figures of the Wisconsin school) may and can be compared with Friedman, Stigler, Becker, Lucas and others? With all the respect for the Wisconsin's probably only Emmett may explain this. With a number of authors that influenced economic thinking throughout the globe and eight Nobel prizes in economics the Chicagoans are without any doubt the most influential school in XX century economics.

Ad c) Emmett believes that the Chicago methodology "is grounded in the combination of two assumptions found in its two most famous methodological articles. Friedman's 'Methodology of positive economics' claimed that progress in economics as a policy science can be significantly furthered by the use of a toolkit of basic models that require little additional theoretical work. Graduate study at Chicago became a process of immersion in those models so that they became so intuitive to one's work that, in combination with new empirical investigation, they opened the door to novel evaluations of market organization and government policy. The other methodological foundation for Chicago economics was codified twenty years later …in the article 'De gustibus non est disputandum'. Friedman's two colleagues /Stigler and Becker – added by MP/ pointed out that an economic policy science must assume that tastes and preferences are universally the same in order to usefully claim that economic phenomena can be explained in terms of changes in the cost sets that decision makers face. Science is not advanced by an explanation that ends with A's tastes are different from B's tastes, or that A's tastes changed." (Emmett, pp. 1-2.) It is a strange characterization of the Chicago methodology that ignores thousands of pages from price theory (merely by Knight, Friedman, and Stigler), and that cuts off some other important Chicagoans *credo*.

Usual summary of the Chicago school centers around price theory and market as an allocation mechanism. This may be extended, so that the Chicagoans move around the following assumptions/statements. First, neoclassical theory provides the theoretical framework for the Chicago authors. Another and interesting question is whether Chicago authors really were faithful to the neoclassic and why they have been mutually different in discussing the neoclassical critical points. This was especially the case with Friedman and Stigler. Second, prices direct behavior of individuals on the market. The question is whether this is the same in the U.S. and Norway, in Korea and Slovakia. Chicagoans tended to say "yes". Third, market is superior in allocation of resources to its alternatives. This sounds credible because other allocation mechanisms require higher transaction costs. Fourth, price theory is applicable to market place as well to phenomena other than classical market of goods and services, like family, regulation, famine, firm, state, etc. Fifth, non-inflationary policies like monetarism color the Chicago view in the sphere of finance and money. This sounds clearer in formulation than in execution and there was a lot of debate on how monetarism is to be understood or how it is to apply it. Sixth, constitutionally constrained government under the rule of law rather than other forms of social organizations, like communist or interventionist welfare state, allows superior economic outcomes. One may argue that this description mixes positive and normative elements. This is true, but a summery ignoring normative and political aspects would *de facto* cripple the description of the Chicagoans methodology.

Above mentioned question of methodology open other questions. As the reader will notice, the editor never declares his principles in conceiving and arranging this selection, what and why is the focus, etc. This is quite apparent when you read the collection. The editor collected what he got rather than what he needed to collect in order to prepare a good and consistent collection. One may get a better insight into the Chicago school conception by reading several pages long article on the Chicago school in the *Palgrave's'* dictionary of modern economics[2] than reading neatly any of the conceptual essays in this collection. There is no system in presentation and analysis of the Chicago authors, there is no divide between what is important and what is not important, there are too many repetitions of facts and titles and the collection is short of good conceptual analysis, with exception of some articles, like that on Alchian written by Daniel K. Benjamin or that on Friedman's monetary history of the U.S. written by Hugh Rockoff. The irony is that the best article is on the author that is very important for economics but rather peripheral to the Chicago school, like Alchian. One needs to add, that Alchian's approach to economics was very different to the Chicagoans; he was closer to the Austrians although he never considered as an Austrian. Nevertheless, there are also those who consider Alchian to be a full fledged member of the Chicago School. Steven Medema has four contributions, and they are also very solid. These are two studies "Adam Smith and the Chicago School" (pp. 40-51), "Chicago law and economics" (pp. 160-174) and two biographical articles (on Ronald Coase and Posner).

The collection creates an impression that the Chicago school emerges in 1890s and ends some 100 years later on, what is not true for sure. The label of the School is marked by the authors like Friedman, Stigler, Becker or Lucas whose academic activity at the Economics department in Chicago lasted between 1940s and 1980s. (Friedrich Hayek never thought at the economics department in Chicago and he was

[2] Cf. Melvin W. Reder (1987), pp. 413-418.

clearly an Austrian, while Coase merely belongs to the Virginians.) What was before, it is probably interesting for the history of ideas, like Laughlin, Veblen or even Knight, and what happened after 1980s is related to the dust of a large and important school. Those who were larger names after Friedman, Stigler or Becker – like Demsetz or Peltzman – have changed Chicago for other academic institutions in the U.S. It is also interesting that Emmett counts law department in the “Chicago school“, but he excludes from the School some prominent authors from the economics department, like Peltzman (mentioned only once on p. 339) or Demsetz (mentioned three times).

It is pity that this collection is conceptually poor because such an analysis should be the core of these types of books.[3] This job is divided into several dimensions. First, one needs to summarize the main convictions of the authors in question. Second, the differences among authors may play an important role, as it was the case in the Chicago school. Important differences require comments and elaboration. Third, a critical analysis of the general tenets and individual profiles is needed. What looks like a school from outside may be a set of a very diversified authors from inside, as it was the case with the Chicago school. Its authors adhered some pro-market tenets, but otherwise they have promoted diversity and mutual discussion, what made the Chicagoans superior rather than inferior to other schools. Finally, a comparison with other more important schools (for example, institutionalism, Austrians, regular mainstream...) is also needed. All these jobs are either missing (Austrians, the neoclassical mainstream, Virginia school[4] …) or they are only partially completed (there are essays on institutionalism and Alchian) in this collection.

The above does not mean that this collection is useless. It provides a lot of interesting materials in bio-bibliographical, historical and theoretical sense. A huge majority of articles may pass theoretical test of current academic production. Some articles are quite good. Good pieces taken in isolation do not necessary provide a good collection. Nevertheless, the main shortcomings beyond the lack of theoretical analysis and scrutiny are the weak criteria for authors and School’s presentation and the lack of analytical rigor. Even if one does not believe in perfection he may ask for a better quality.

[3] Like Warren Sammuels (1992), Johan Van Overtveldt (2009), and others.
[4] There is the essay “The Chicago Roots of the Virginia School” written by Gordon L. Brady (pp. 233-249), but there is no a study to compare the Chicagoans and Virginians.

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