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Their Blackboard, Right or Wrong: A Comment on Contested Exchange

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WILLIAM James spoke ruefully of his Pragmatism that he expected it to "run through the classic stages of a theory's career. First, you know, a new theory is attacked as absurd; then it is admitted as true, but obvious and insignificant; finally it is seen to be so important that its adversaries claim that they themselves discovered it."¹

I am going to save time and run the theory of contested exchange by Bowles and Gintis through all three of James' stages at once. The saving of time will involve some harshness of tone, for which I apologize. I am sure Bowles and Gintis are not so emphatic as is their paper; neither, really, am I. And in all sincerity their intellectual reach and grasp in arguing so hard against the mainstream view is admirable. It is mistaken, but it is admirable.

Not altogether incidentally I should note that Bowles and Gintis come from different politics. I do not like their politics, not one bit. As a youth I was a Trotskyist. The light, however, has gradually dawned, and I have grown suspicious of the fourth unbelievable statement: "I'm from the government and I'm here to help you form a worker co-op." The help that governments can give to worker co-ops is the help the Soviet government once gave to them: jail, threats, and regulation.

But some points in the article are helpful even to a libertarian and neoclassical economist like me. The rhetorical plan of the article is to argue in terms that the neoclassical opponents appreciate. As I have said, the plan is admirable; a similar and similarly admirable plan is adopted by Stephen Marglin, say, or from the other

side by Douglass North. We are not going to make progress in economics until we discover how to talk to each other without talking past each other. Substantively I agree that Marx attacked the classical economic model for being, as Bowles and Gintis put it, "devoid of human agency and untouched by either memory or anticipation"—one might say untouched by memory and desire, stirring dull roots with spring rain. Marx in this account was trying to bring stories back into a synchronic economics.²

The Bowles and Gintis approach can be summarized as saying that much of the economy operates face to face. That also makes a lot of sense to a Good Old Chicago School economist or to anyone else who has noticed how much businesspeople talk to each other. David Lodge describes a businessman in his recent novel, *Nice Work*, through the eyes of Robyn Penrose:

[I]t did strike [her] that Vic Wilcox stood to his subordinates in the relation of teacher to pupils.... [S]he could see that he was trying to *teach* the other men, to coax and persuade them to look at the factory's operations in a new way. He would have been surprised to be told it, but he used the Socratic method: he prompted the other directors and middle managers and even the foremen to identify the problems themselves and to reach by their own reasoning the solutions he had himself already determined upon. It was so deftly done that she had sometimes to temper her admiration by reminding herself that it was all directed by the profit-motive.³

The new interpretive economists, such as Arjo Klamer of George Washington University and Metin Cosgel of the University of Connecticut, have been trying recently to formulate a theory of the entrepreneur as a rhetorician, a persuader of bankers and workers. The theory makes sense, reuniting the humanistic with the scientific parts of economics, and has large implications for research. People of different politics can agree on the importance of such a project in economics.

My main critical point is this: The Bowles and Gintis argument is old and simple. To use James' stages, the theory of contested exchange is absurd because it is a case of blackboard economics, and blackboard economics gets more absurd with each issue of the *Journal of Economic Theory*. The theory, further, is true but obvious, obvious because it merely rewrites the conventional notion of transaction costs in the language of conflict; and it is insignificant because the blackboard propositions in the paper are not confronted with the world. And finally the theory is so important that the Good Old Chicago School claims to have discovered it when Bowles and Gintis were in knee pants. (I am distinguishing as I wish other people would between Nouvelle Chicago, which has turned to blackboard economics, and the Good Old Chicago School, which tries to explain worldly facts in the line of Knight-Schultz-Friedman-Coase-Becker and the famous offshoots at UCLA and Virginia.) The article in short is a ponderously formalized version of Good Old Chicago School theories.

Bowles and Gintis are saying that in the face-to-face parts of the economy the more powerful person can exploit another person within the limits imposed by the ability to move. Under capitalism, man exploits man (under socialism it is the other way around). Marriage is probably the most important case although Bowles and Gintis think that the workplace is. A marriage makes it difficult to move out from under abuse and neglect and exploitation. The exit option, as Albert Hirschman puts it, is not always easy to take. One often does not help a battered wife by saying to her, "It's a free country: Why don't you exit?" She feels trapped, and to the extent she feels that way or is legally placed in such a position, her husband can beat her.

To put it in more elaborate terms, transaction costs put walls around institutions the way transportation costs put walls around an island. In a nutshell, the contested-exchange model of Bowles and Gintis is the story of what happens inside the walls. Calling exchanges with transaction costs "contested" gives it a marxoid tone, but otherwise (as Bowles and Gintis admit) their story is the old and Chicago one of transaction costs.

The wall metaphor is how economists of whatever school would explain the argument to outsiders. They would explain it to themselves with an analogy to international finance. The cost of getting into and out of a job, a marriage, or a country is like the cost of getting gold into and out of New York. At some differential between the price in Hong Kong and the price in New York the gold will flow from New York to Hong Kong; at the opposite differential it will flow in the opposite direction. Economists call the two differentials "the gold points" (the jargon is taken from financial markets). At the gold points "the market works." That is, you will not find gold selling in New York for a price higher or lower than what it costs to bring some gold from Hong Kong. The New York price is limited by competition from Hong Kong in the usual economic way.

But inside the gold points the market doesn't *work*. This just means that strictly inside the range of prices set by the gold points a speculator would not find it worthwhile to send gold from one place to another. Something else determines the price *within the gold points*. Outside the gold points the prices are determined by international competition; inside the gold points they are determined by something else—in the case of gold by domestic as against international supply and demand, which amounts to the gold points between one vault in New York and another.

You can see from the analogy that whether or not the market *works* depends entirely on how closely you are examining it. The market is like a postimpressionist painting. If you step back and squint, the gold points fade to insignificance, and there is effectively one world price for gold. The same is true for labor if you squint a lot more. When you get closer to any market, though, you start seeing the brush strokes. The close view is no more real than the distant view. It may be

more or less convenient for this or that human purpose. That is all. Saying about a painting by Seurat that it is *really* just a bunch of dots is not intelligent. Likewise to say that the market for loans or labor are "nonclearing" is to use words in a strange way. It would be like saying that the market for bricks is nonclearing because there are gold points (that is, brick points) between Iowa City and Cedar Rapids. The extent of nonclearingness depends on what we want to do with the notion of clearing or how we want to think about the economy of eastern Iowa. It is a matter of how far we wish to stand from the painting.

Bowles and Gintis go to a good deal of trouble to show that "employment rents...will exist in a competitive equilibrium of a contested exchange." The trouble was unnecessary. The proposition is obvious and needs none of the paraphernalia of proof. If there are gold points then within the limits of the gold points, there can of course be price differentials advantageous to one or the other party, caused by bargaining, law, or violence. Within the gold points, one person can exploit another.

We economists know this already and do not need to be told of it again in the abstract, and most especially we do not need to be told it about the labor market. Adam Smith noted a long time ago that "After all that has been said of the levity and inconstancy of human nature, it appears evidently from experience that a man is of all sort of luggage the most difficult to be transported."⁴ Therefore the gold points in the market for labor are by some standards large. "In the one case the advantages of the employment rise above, in the other they fall below the common level."⁵ Therefore the competition with other laborers does not fix the wage to the eighth digit.

In other words, the theory in the article is true but painfully obvious. *Of course* within the gold points there is power. Economists have always thought so. In particular the Good Old Chicago School has always thought so. For example, the "employment rent" spoken of by Bowles and Gintis is what a worker can get away with once he has a job, the prize for getting employed in a cushy job (that is, one with high rents) and the temptation to remain unemployed the better to try for it. Good Old Chicago School economists like A.C. Harberger and Larry Sjaastad have been making the same point for two decades, using it to explain high unemployment in Latin American cities.

Bowles and Gintis revive Marx's focus on how the boss extracts labor from labor power, that is, how he gets the workers to work. Gary Becker has written on the subject recently, Oliver Williamson earlier, but in any case it is the entire subject of Chicago's property rights economics (or of management science, for that matter). Bowles and Gintis assert that the neoclassical model requires an actor "who obligingly declines to pursue his interest in any relationship plagued by agency problems." The phrase "the agency problem" has for 15 years been a leading obsession of the University of Chicago Graduate School of Business,

which has carried on the traditions of the Good Old Chicago School after their sad demise over in the Social Science Building.

A straw man named "Walrasian general equilibrium" plays a big role in the Bowles and Gintis article, but again a Good Old Chicago School economist must object. It is passing strange to identify the straw man with actual men of Chicago such as James Buchanan, Milton Friedman, Armen Alchian, and Harold Demsetz (not to speak of Mises and Hayek). Chicago long resisted the desiccated charms of general equilibrium. To be sure, the skeleton Walrasian model beloved by blackboard economists the world over does in fact rely on a "critical assumption that conflicts of interest...are resolved in contracts which are either voluntarily observed [not 'seen' but 'obeyed'] or are enforceable in no cost to the exchanging parties." But as I say, the Good Old Chicago School has been exploring the consequences of relaxing this assumption, in a case-by-case, empirical way, since about 1959.⁶ The Good Old Chicago School has in fact a lively awareness that politics precedes property and that society precedes politics. It puts great emphasis, for example, on the issue of education in economic growth. Not the Chicago-UCLA-Virginia crowd but rather the mainline neoclassicals at Yale and Stanford are responsible for reducing economics to routine calculation by fourth-rate mathematics.

But the most important doctrinal flaw, to repeat, is that the "Contested Exchange" of Bowles and Gintis is merely the negotiation within the gold points that Chicago economists such as Ronald Coase and Armen Alchian first emphasized. It is therefore strange to attribute to Alchian and company such a notion as that there exists "a costless means by which A [their helpful mnemonic for the boss] can enforce a specific level of effort." A major task of the Good Old Chicago School has been to look into the enforcement of effort, as in the studies of sharecropping by S.N.S. Cheung⁷ and J.D. Reid, Jr.⁸ The Chicago work may be a trifle narrow. But in both the new Marxist and the Good Old Chicago School the game is to find a *rational* explanation. Chicago got there first by about three decades.

Chicago called it "transaction costs," a colorless phrase that admittedly opens the distasteful possibility that capitalism might be viewed as something other than conflict and exploitation. But at least the Chicago phrase has the merit of inviting someone to measure it. That is the second problem with the article, following on the doctrinal flaw: Bowles and Gintis do not direct our attention to measurement.

A Chicago phrase makes the point. Milton Friedman is fond of asking people "How do you know?" In the clatter of stylized facts and blackboard metaphors that is economics these days the Friedman question is a stunner. How *do* you know? As a first-month assistant professor 20 years ago I was retailing back to Milton at a cocktail party his very own argument that professional baseball was a monopoly. "How do you know?" said he. Jeepers, I dunno. Milton told me so.

In the Good Old Chicago School of Milton Friedman, Margaret Reid, Arcadius Kahan, Robert Fogel, Theodore Schultz, Gale Johnson, Mary Jean Bowman, Leland Yeager, Gordon Tullock, Lester Telser, and George Tolley, to name a few, you had to know what you were talking about, factually.

I suppose Bowles and Gintis know what they are talking about, factually. But the article does not show it. The article is packed with little quantifying words, as is most economic theorizing, but words with no cash value, to use a Jamesian turn again. It speaks quantitative words in nonquantified contexts, hypothetical quantification. Thus the sketch of the argument for "new microfoundations for political economy" features prominently (you can count them) words like "extensive," "reality," "fundamentally." How extensive? Real by what what standard? How fundamental? But answer comes there none.

Bowles and Gintis elsewhere begin a sentence with "if one were *rightly* to dismiss *on empirical grounds*...the Stakhanovite...worker." Well, how do you know? Let us see the empirical work that shows workers to be alienated. (I gather from note 33 that Michael Burawoy has made a point about alienation similar to the one I am making.) Marx certainly did not know about alienation, this man who never worked with his hands. Listen to the longshoreman and sage Eric Hoffer, who did:

It is mainly by work that the majority of individuals prove their worth and regain their balance....No one would claim that the majority of people in the Western world...find fulfillment in their work. But they do find in it a justification of their existence....[E]ven a job of the sheerest routine yields the individual something besides the wherewithal of a living.⁹

The point is not that Hoffer's ruminations are knock down arguments. The point is that Bowles and Gintis are not entitled to say *how far* capitalism deviates from some ideal unless they have taken its measure. And the measure is the only intellectually interesting issue. The blackboard will not reveal the secrets of the world.

The question, to use a technical word, is whether any of their propositions One to Nine have oomph. Oomph is what we seek in social theorizing—not propositions that stay up on the blackboard but propositions that get down to work in the world. About halfway through the article Bowles and Gintis say "we have not shown that the exercise of this power is socially consequential." A critical reader will mutter, "Damned right," and hope that now at last he will get served some evidence of oomph. The hope is disappointed. Bowles and Gintis continue claiming that thus-and-such an assumption or conclusion is "insupportable" or "important" without saying how they know.

The article, in other words, does not make a theoretical contribution, if by *theoretical* one means something like "noting possible effects (with or without oomph) that most people have not noticed." Every adult economist has noticed

all nine of them. Not only have they noticed them, they have written them; indeed they have lived them.

Therefore the only way the article can advance its case against capitalism is empirically. In explaining technological change, for example, we need to know *how important* is the motive of control over the workforce as against the efficiency of new technology. How much oomph has (say) the class struggle got when set beside the desire for greater efficiency? How do you know? You cannot answer such questions at the blackboard. You have to go into the library or into the street.

It is not as if the questions are unanswerable or are somehow biased against the left. William Lazonick and other Marxist historians have tried to answer them (although even they sometimes fall back on proofs of the existence of an effect, sidestepping the question of its oomph). Bowles and Gintis, by contrast, let the oomph fall where it may.

To give another instance, the paper strains to show that the traditional bad guy—the boss or the banker—has the whip hand. In the world, of course, sometimes he does and sometimes he does not. It depends. It cannot be settled at the blackboard. The evidence needs to be examined. As Bowles and Gintis say in another connection, "the choice of emphasis cannot be determined by methodological fiat." Right. It is not much of an argument, for instance, to call the worker's side "the long side" (an idiosyncratic usage by the way) and then declare without evidence that the long side is always the loser. Borrowers can and do sometimes exploit lenders. Workers can and do sometimes throw *sabots* into the machines.

In this connection Bowles and Gintis are really quite amusingly unfair when they sneer about Alchian and Demsetz, "Whence flows Alchian and Demsetz's belief that one can walk away from one's employer or creditor with as little concern as one crosses the street to shop at one supermarket rather than another" (p. 14). Alchian and Demsetz would of course never say such a silly thing since the transaction costs of job and creditor search are usually greater than those of apple search (although they are not greater, for example, in a place with no apples). The idea of transaction costs is superior to the Bowles-and-Gintis formulation of the same idea (power in a contested exchange) because transaction costs suggest we measure them (as Douglass North and John Wallis have, for example). The idea of power, apparently, does not.

I could give many more examples of oomphless arguing in the article. Try me. Look at Proposition 3, for example, colorfully called "Divide and Rule." It says that contested exchange (– transaction costs) may result in racial discrimination. Sure; of course; so what else is new? Within the gold points we are in a world of power. The scientific issue is what the oomph of such power is. How fuzzy is the picture, and what degree of fuzziness will do for the purposes at hand? If the

gold points are small, then the power will be small, at least if you stand back and squint.

I suppose there is some Marxist writer who confronts the matter of how large are the gold points of discrimination, though I have not encountered one. The capitalist writer on discrimination that Bowles and Gintis attack is Milton Friedman. Friedman argued a long time ago that discrimination might be eroded by the pursuit of profit. Even he had some small start on answering "How do you know?" since his family had been employed as sweated labor in the New York garment trade, and he knew also about antisemitism in the less competitive industry that his progenitors' sweat got him into. In any case his students, such as Gary Becker, and Gary's students, such as William Landes, have given a great deal of attention to the oomph in discrimination. They have explored empirically, for example, the possibility that after all the bosses will go on discriminating in the teeth of lost profits. They have measured the profits and examined the consequences. As Milton would say, it is an empirical matter. On this as on some other (but not all) issues between Marxists and capitalists, the worst capitalists have done the best empirical work.

But it is of course unfair of me to complain in this way about the affection that Bowles and Gintis show for the blackboard. For one thing, Bowles and Gintis have shown elsewhere that they are more willing than most economists to go to the library. For another, everyone does it. Economists are besotted with the blackboard.

That is my real complaint, and I merely use their article as an occasion.¹⁰ The general form of *theoretical* papers in economics—a category that is approaching asymptotically to 100 percent of the papers—is the assertion of a connection between a set of assumptions and a set of conclusions. More exactly, since papers are made from earlier papers, it is an assertion that new assumptions lead to new conclusions. The argument put forward, in its middle parts so very precisely, is usually vague to the point of scandal in its beginning parts—about why the new assumptions are to be preferred to the old. The new assumptions are said to be more realistic or less restrictive or something else obscure and untried. After a middle passage through pointless precision the argument again becomes fuzzy at the end, where the policy implications are brought forward. More intellectual scandal. Because of the tangency of curves on a blackboard we are to adopt a policy of free trade. Because of a lack of tangency we are to overthrow capitalism.¹¹

Thus in another paper by Bowles and Gintis, circulating in draft¹² (on the same theme and with many of the same arguments as the paper under discussion), the Walrasian model is attacked in terms such as "*sufficiently* subject...*even approximately* valid...*severely* compromises," all quantitative. A few pages later Bowles and Gintis wax wroth at the "untenable" character of free enforceability

of contact "failing egregiously." Wait a minute. These are empirical assertions. One cannot settle them on the blackboard. The standard by which the Bowles-and-Gintis new assumptions are better than the old is not articulated. To get from the blackboard to the world you have to show that the effects are large. Bowles and Gintis do not do this, and neither do most other economists.

This will not do. We cannot go on in economics taking in each other's washing. Or, to put it in terms that economists will like, we cannot go on searching aimlessly (unless the aim be tenure) through the hyperspace of new assumptions. The problem is that there is a theorem on theorems:

The Metatheorem: For each and every set of conclusions C and a set of conclusions C' at a given distance from C (for instance, the opposite of C), there exists a set of assumptions A that imply C and assumptions A' that imply C' such that A' is within an arbitrarily small neighborhood of A in any metric you care to choose.

which is to say that the implicit program of modern economics, stuck on the blackboard, has not gotten anywhere and shows no signs of doing so. I hope the news of the intellectual catastrophe in modern economics gets out soon enough to prevent the sociologists and political scientists (especially the political scientists) from ruining their subjects, as they seem intent on doing.

To put it still another way, much of modern economics works with a rhetoric of proof that is not defensible. The rhetoric of proof is that we can solve great social problems standing at a blackboard. This is the rhetoric of the math department. It is perfectly suitable there, since the problems to be solved in the department of mathematics are about mathematical objects, not social objects. But the rhetoric of the mathematics department bears little resemblance to that of the department of physics or history or any other field that economics should admire for a scientific character. Math is not science; it is the handmaiden of science; the science is in the systematic explanation of phenomena. We can prove the *existence* of contested exchange at the blackboard in an infinite number of ways from an infinite number of assumptions, A to A' to A'' to A''' to A^N . There is no point in trying to map out the infinitude. To actually know about the oomph of contested exchange (read transaction costs) we are going to have to look at the world.

The blackboard method requires its theorems to be qualitative, that is to say that they not depend on quantities. Since 1947, when Paul Samuelson published his Ph.D. dissertation, we in economics have been on a wild goose chase to find theorems provable by mathematical means that will miraculously give us a purchase on the world without having to venture out into it. Such a project had to be tried, I suppose, in view of human optimism, but unhappily the chase has not captured a single goose. Maybe a stray feather or two, but no complete animal.

I and most other Good Old Chicago economists think that the chase has been a diversion of talent and that we should now get back to serious scientific work. Thorstein Veblen once described sports as having "the advantage that they provide a politely blameless outlet for energies that might otherwise not readily be diverted from some useful end." As he said of British shooting and polo, so one might say of general equilibrium and game theory, and even the admirable theory of contested exchange: look with dismay, oh reader, on "the elaborate futilities of general equilibrium or such a *tour de force* of inanity as game theory." The games are not getting anywhere. Time to blow the whistle.

NOTES

1. William James, "Pragmatism's Conception of Truth," in *Essays in Pragmatism* (New York: Hafner, 1948), pp. 159-176.
2. For what economics needs to do, see Donald McCloskey, *If You're So Smart: The Telling of Economic Stories* (Chicago: University of Chicago Press, 1990).
3. David Lodge, *Nice Work* (London: Penguin, 1988), p. 219.
4. Adam Smith, *The Wealth of Nations*, Cannan ed. (Chicago: University of Chicago Press, 1976), p. 84.
5. *Ibid.*, p. 129.
6. Ronald H. Coase, "The Problem of Social Cost," *Journal of Legal Issues* 2 (1959): 1-44.
7. Steven N.S. Cheug, *The Theory of Share Tenancy: With Special Reference to Asian Agriculture and the First Phase of Taiwan Land Reform* (Chicago: University of Chicago Press, 1969).
8. Joseph D. Reid, Jr., "Sharecropping as an Understandable Market Response—The Post-Bellum South," *Journal of Economic History* 33 (1973): 106-130.
9. Eric Hoffer, *The Ordeal of Change* (New York: Harper, 1964), p. 34.
10. I have more to say in "Formalism in Economics, Rhetorically Speaking," *Ricerche Economiche* 43 (1989).
11. Recent papers by William Milberg and Hans Lind have examined closely the rhetoric of proof in international economics. Much of the work, they note, goes on in the vague ends of the papers rather than in the precise middles.
12. Samuel Bowles and Herbert Gintis, "Power and Wealth in a Capitalist Economy," unpublished paper.