“The Curious Case of William Niskanen: A Case in Business Ethics?”

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Abstract

While at Ford Motor Company Bill Niskanen (1933-2011) refused to write a corporate memo endorsing trade barriers against more fuel efficient Japanese imports. For this he got fired (Weber 2017). Niskanen then went on to the Reagan Council of Economic Advisors (Niskanen 1988), where again he left due to disagreement over trade-protectionism policy. Next we find Niskanen at the Cato Institute (Boaz and Crane, ed. 1993). Our work is in draft but we hope to have a clearer picture by the time of our meeting in New Orleans. In turn, this is a chance to formally revisit the teaching opportunities of Supply and Demand heuristics (Blaug and Lloyd 2010, Tullock 2005), and examine in addition to the deadweight loss and surplus transfer, the reduction in absolute living standards due to government intervention in trade using this heuristic. This is an opportunity to tie Niskanen’s aversion to protectionism as an aversion to theft, like that of Tullock’s perhaps original formulation.

Key Words: Political Economy, William Niskanen, Public Choice, Economists, Bureaucracy

JEL Codes: A11, B3, H1, K2, L53

[1] I have no subsidies received in this research.

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A common commitment to refrain from special favors serves the same economic function as a common commitment to refrain from stealing – Bill Niskanen ca. 1980

I. Introduction

William A. Niskanen, Jr. (1933-2011) is an idiosyncratic figure in American economics. On the one hand, he is an establishment figure, educated at Chicago and Harvard, a faculty member at U.C. Berkeley, defense analyst at the RAND Corporation, an assistant director in Nixon's Office of Management and Budget, chief economist at the Ford Motor Company and a member of the Council of Economic Advisors under President Reagan. Niskanen was one of Reagan's early appointees and served on the CEA for four years, including six months as acting director. On the other hand Niskanen is an idealist and iconoclast. Niskanen was fired by Nixon OMB director George Shultz for pointing out the dishonest fiscal reporting by the Nixon Administration, was fired by Ford for not supporting trade protection against Japanese automobiles and he quit Reagan's CEA because of a clash with then Treasury Secretary Don Regan over tax policy.[2] Regan vetoed Niskanen from becoming Chair of the CEA when Regan became Reagan's Chief of Staff (Poole 2011, Segal 2011). After this Niskanen serves as chairman of the Cato Institute for 25 years.

The epigram which starts this paper is from an internal memorandum that Niskanen wrote while the chief economist at Ford, we only can surmise, in the late 1970s or early 1980 (he was fired from Ford in 1980) while Ford is trying to engage in what is now recognized by some as political capitalism (Segal 2011), managerial capitalism (Gérard and Lévy 2018), or as I prefer, crony-capitalism.

> Ford's rent-seeking peaked in 1980 when senior management decided to lobby for federal import restrictions against Japanese automobiles, ironic for a company that in the era of Henry Ford and Henry Ford II had been a force for open trade and internationalism. Ford's chief economist, William Niskanen, who left a tenured position at the University of California at Berkeley in 1975 to join the company, was nonplussed. In meetings and memos he bluntly admonished Ford's top brass to either meet the competition or get out of the car business. One memo came with a philosophical flourish: "A common commitment to refrain from seeking special favors serves the same economic function as a common commitment to refrain from stealing" (Bradley, Jr. 2018).

We have not found anything by Niskanen that directly references Gordon Tullock (1967), where Tullock discusses the similarities in economic welfare losses due to trade policy which creates

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[2] "He [Regan] was uncomfortable dealing with people on a collegial rather than a hierarchical basis" (Niskanen 1988, 292).

monopolies and that of theft. We know that Niskanen and Tullock (1922-2014) worked together at the Institute for Defense Analysis during the summer of 1967 (Niskanen 2008, 314). We also know that Niskanen and Tullock discussed Tullock's work on protectionism as (legal) theft. Niskanen is credited with a helpful observation in Tullock's canonical piece from 1967, "The Welfare Costs of Tariffs, Monopolies, and Theft" in the *Western Economic Journal*.[3] We find that the Ford memo, Tullock's (1967, 232) footnote on Niskanen and Niskanen's (2004) review of the first volume of Tullock's collected works seem to be the only cross-references these political economists have with each other regarding trade policy.[4] Thus we can only guess that the epigram is an allusion to Tullock (1967).

What we are going to do in this paper is illustrate and make advances upon Tullock's work on the costs of what is now known as "rent-seeking" (Krueger 1974, which is understood as the canonical piece which establishes Tullock's 1967 observations, see for example Blaug and Lloyd 2010, 204-208). In this method we will help further define Niskanen's idea that trade protectionism is a form of stealing in that it leads to decreased standards-of-living except for all but perhaps the "thief".

First we might project why we might think that the epigram refers to Tullock eventhough we have yet to find any evidence that Niskanen draws from Tullock for his free-trade analytical predispositions. This is from Niskanen's review for the *Cato Journal* (2004) of Tullock's collected works published by the Liberty Fund. We find Niskanen's respect for Tullock's work.

> Tullock has maintained a roughly constant utilitarian perspective on each of these issues. But he does not insist that utilitarianism explains all human behavior, only that part which is explainable without knowing the distinctive personalities and biographies of those involved. In addition to his coauthorship of the *Calculus of Consent* (with James Buchanan), the major individual contributions for which Tullock still deserves the Noble Prize are his proofs that democracy usually works rather better than suggested by the theories of Kenneth Arrow and Duncan Black and that the social costs of inefficient policies are substantially larger than suggested by Arnold Harberger. But there should also be some reward, wherever economists spend their afterlife, for making valuable contributions to so many subjects, for good writing, and for relatively little use of mathematics (Niskanen 2008, 314).

II. The Harbinger Triangle and the Tullock Rectangle

Let's explore Tullock on Harberger now. In a section entitled 'Rent-Seeking: Early Beginnings' in Volume 5 (2005) of his *Collected Works*, Tullock writes,

> Such a preoccupation with monopoly in the burgeoning literature of industrial organization during the late 1950s and early 1960s, for me, presented something of a paradox. Perhaps instinctively, or perhaps because of my early price theory training, I shared the prevailing view that monopoly was a significant evil, worthy of the attention that it produced. Yet, I was aware of two widely-cited papers that had determined that the loss of economic welfare caused by monopoly in the United States was very small, perhaps the order of

[3] Tullock is discussing how the 'gamble' of lobbying for special treatment under law is costly. "The cost of a football pool is not measured by the cost of the winner's ticket, but by the cost of all tickets" (Tullock 1967, 232). The footnote to this sentence reads, "This helpful analogy was suggested to me by Dr. William Niskanen" (Tullock 1967, 232 fn15).

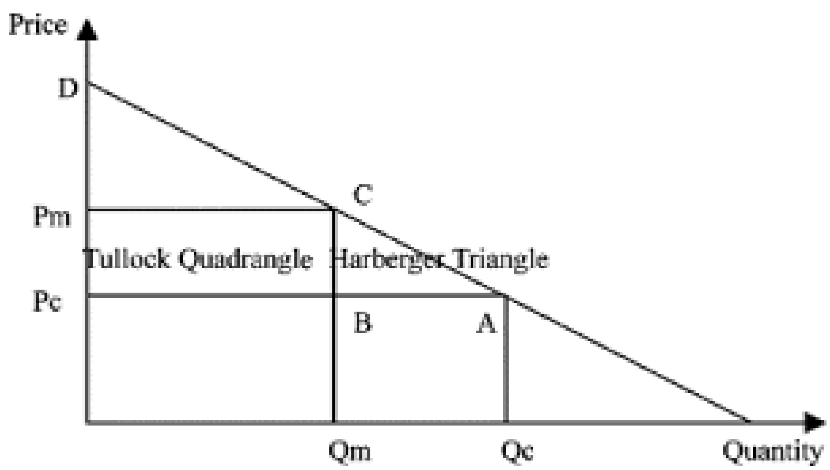
[4] Niskanen and Tullock reference each other numerous times in the literature on "bureaucracy".

one-tenth of one percent of gross national product. Since this conflict between my instinct and my observation eventually triggered my 1967 paper on rent seeking, let me begin this book by revisiting Harberger's contribution [citing Harberger 1954 and 1959].

> Harberger defined the loss of economic welfare associated with monopoly as the excess of the loss of consumers' surplus over the gain to the monopolist. The gain to the monopolist was his net profit, which, in the constant cost model, is the difference between his price and the competitive price multiplied by the quantity sold at the monopoly price (Tullock 2005, 11-12).

Figure One shows an example of the original formulation of the Harberger triangle and the Tullock rectangle [labelled 'quadrangle' *sic*]. Tullock (2005, 13, Figure 1) calls what has become known as his rectangle "Excess profits". Excess profits are the difference between the competitive price and the monopoly price multiplied times the quantity transacted at the new lower monopoly quantity. We should note that Tullock does not name this rectangle in his 1967 paper, it has only subsequently become part of the conventional wisdom in economics.

Figure One[5]



Tullock develops his 'rectangle' to illustrate his idea that the costs of rent-seeking (the costs of lobbying) are not fully captured in Harberger's triangle. As stated, when undertaking his work Tullock believed that, in competitive equilibrium, the costs of lobbying would approximate the excess profits, thus the Harberger triangle underestimates the economic loss to society due to rent-seeking because the triangle does not capture the costs to society of lobbying. If the costs of lobbying (gaming the political system for special treatment under the rule of law, or, 'capturing' the economy[6]) are taken into consideration, then the excess profits (Tullock rectangle) should be added to the Harbinger Triangle to better capture the economic welfare losses of intervention creating monopoly power.

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[5] Source: The first image to appear when I googled "Tullock Rectangle Images".
[6] See Lindsey and Teles (2017) for a comprehensive discussion on capture in the U.S. economy today.

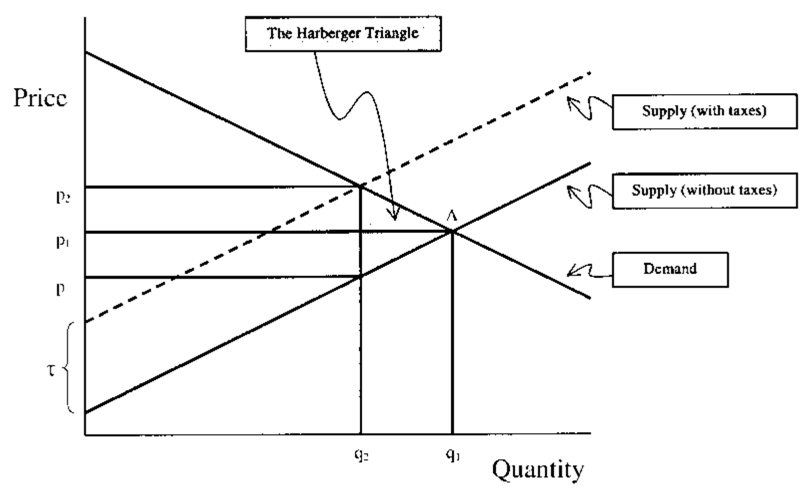
However by 1980 Tullock is rethinking his position on equilibrium economics as applied to rent-seeking.

> My "Efficient Rent Seeking" [1980] raised a mathematical issue having to do with the lack of an intelligible equilibrium in many rent-seeking cases. The lack of equilibrium could lead to either overinvestment or underinvestment of resources in rent-seeking. Thus the Tullock Rectangle remains as only an approximate measure of the cost of rent-seeking (Tullock 2005, 297).

III. The Costs of Protectionism Revisited

In this section of the paper we present advances upon Tullock's original ideas of the costs of lobbying (later known as rent-seeking[7]). Specifically we introduce both Demand and Supply dynamics to what Tullock had original introduced as neo-classical equilibrium analysis, where under the perfect competition assumption the firm (industry) is a 'price-taker'. By introducing the intersection between supply and demand in the market, with exogenous policy shifts due to state intervention, we can bring new discoveries into the public choice paradigm of rent-seeking in trade policy. For example, Hines (1999) finds that the Harbinger Triangle should include the producer surplus lost as well as the consumer surplus lost, economic loss which is greater than Tullock's formulation for the original Harberger Triangle. By the time of Mankiw (2012) the expanded Harbinger Triangle has now become the textbook Deadweight Loss.[8]

Figure Two[9]



[7] For a critique of the term 'rent-seeking' as a substitute for lobbying, given that sometimes economic 'rents can be *earned* through entrepreneurial risk-taking, see DiLorenzo and Block (2017). The authors ask on the first (un-numbered) page, "Why pick on innocuous 'rent' to describe crony capitalism?"
[8] "Deadweight Loss: the fall in total surplus that results from a market distortion, such as a tax" (Mankiw 2012, 481).
[9] From Hines (1999, 2, Figure 1).

Next we introduce our own contribution to the theory of rent-seeking, and the economic welfare losses due to state intervention, see Figure Three. We also hope that this discussion will help clarify the narrative presented earlier in this paper.

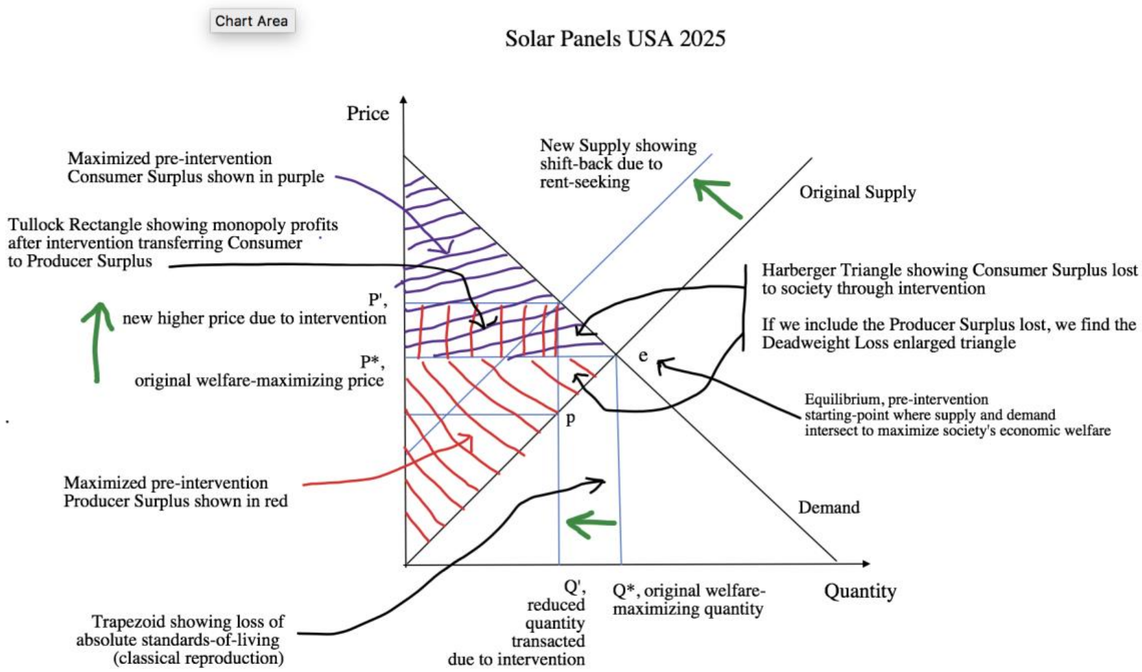
For our purposes we are using the Solar Panel Market in the USA, though the Automotive Market may work just as well. We start with the competitive, pre-intervention, result which maximizes Consumer and Producer Surplus at emerged quantity Q* and emerged price P*. Then, like all rent-seeking, special-interest groups, in this case the solar panel manufacturers in the USA, they lobby Congress and the Administration to gain special anti-competitive treatment under law, in our case, non-tax trade barriers against the importation of solar panels.[10]

By placing non-tax trade barriers in a market, the Supply shifts back, resulting in a higher price (P') and less quantity transacted (Q'). We find the Tullock Rectangle in the transfer of surplus from consumers of electricity (everyone) to domestic solar manufacturers (special-interests being protected from competition). We also identify the original Harberger Triangle in the loss of consumer surplus due to the intervention, as well as the enlarged Harberger Triangle (Deadweight Loss) which includes lost Producer Surplus as well as the lost Consumer Surplus.

[10] The Obama Administration first placed trade-barriers on Chinese solar panels in 2012, after winning a case with the World Trade Organization arguing that China was 'dumping' solar panels on the USA. The barriers placed were tariffs. However in Figure Three we are using non-tariff barriers as these types of trade-barriers are more ambiguous and arbitrary such as content requirements and quotas (or outright prohibition like the international war on drugs). Non-tax trade barriers are consistent with bureaucrats seeking not just power, but discretionary power (Niskanen 1971, Niskanen 2012), so our formulation may be the more general case. For example, the United States–Mexico–Canada Agreement (USMCA) contains extensive content requirements.

The Friedman's (1985) concept of the *iron triangle* of politicians, bureaucrats and special interests can help explain why solar panel trade barriers continue into the Trump Administration. It is harder to explain why an administration and a political party that proclaimed to see climate change as a serious existential threat would make solar panels more expensive and therefore less of them.

Figure Three[11]



An application from Classical Economics

At this point we would like to add our extension to the understanding of the economic welfare loss due to intervention in the Supply and Demand model. If we view society or the economy, as Smith, Ricardo and Marx and other classical economists did, as first a system which reproduces itself, then anything beyond this material reproduction represents a surplus. We can visualize this relationship in Equation 1.

Reproduction + Surplus = Economy (Society) (1)

The intervention not only reduces surplus as shown in Figure Three as the Deadweight Loss and the Tullock Rectangle. We also have a reduction in reproduction, or of absolute standards-of-living. This welfare loss is shown by the trapezoid Q*Q'pe, representing foregone reproduction due to the reduced volume of transactions. Rent-seeking not only reduces surplus it also reduces reproduction, or absolute standards-of-living. This finding is not new, we are just presenting it in a new way. Others have found the same result when using the Production Possibility Frontier model (see Krueger 1974 and Blaug and Lloyd 2010, 204-208).

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11 Source: Author

Further we can shed light on Tullock's finding that, assuming perfect competition equilibrium, the societal costs of rent-seeking would equal the monopoly profits of the special-interest group(s) gaining protection from competition. The classical economists believed that only productive labor creates value. Tullock's monopoly profits are a transfer of surplus from consumers to producers. This transfer of course represents unproductive labor.

IV. Back to Niskanen

The story we are telling here is about Bill Niskanen as a case study in business ethics. We have already found Niskanen at Ford being fired for his (Tullock's?) observation that seeking trade protection is a form of theft. Niskanen carried these ideals into his tenure with the Reagan Administration.

> The administration addressed two trade cases in the spring of 1981 before completion of the trade policy statement, which set a pattern for decisions on later cases. The most important of these cases concerned the import of automobiles. I was especially sensitive about this issue. As chief economist for Ford Motor Company, I was fired in July 1980 for my internal opposition to the petition by Ford and the United Auto Workers for "escape-clause" restraints on auto imports. In September the International Trade Commission (ITC) rejected this petition on the basis of a finding, which I had anticipated, that the increase in imports was not the primary cause of the decline in the sales of domestic auto. This ITC decision provoked candidate Reagan, speaking to Chrysler workers in Michigan, to pronounce that "one way or another," Washington must convince the Japanese to reduce their auto sales in the U.S. market.
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> The position of the new administration on auto imports emerged from the auto industry task force, headed by Transportation Secretary Drew Lewis. This task force reflected a broad agreement on the proposed reduction of auto regulations but divided sharply on import limits, both to meet the campaign commitment and to defer pressure for a quota bill promoted by Sen. John Danforth. Regan, Stockman, and Weidenbaum opposed the auto limits, arguing that the protection of such a visible industry could undermine the whole economic program; at that time they were unaware that Lewis was working with Meese and Baker to develop some sort of import limit. This issue came to a head at a task force meeting with the president on March 19. After the two groups made their points, the president was still reluctant to endorse a specific U.S. position, no vote was taken, and no formal decision was endorsed. The final position developed, without further review, from the initial Meese-Lewis understanding. The proposed reductions in auto regulation were announced on April 6 without any position on import limits. In late April Brock flew to Tokyo to "confer" with the Japanese, and voila! – on May 1, the Japanese announced a "voluntary restraint agreement" (VRA) to limit their export of cars to the U.S. market. The Japanese agreed to limit their exports to 1.68 million cars during the first year, with some unspecified increase in each of the two following years.
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> This method of imposing a quota on imports from a specific country represents an envasion of both US trade law and the General Agreement on Tariffs and Trade (GATT) and was used for both autos and the later steel cases specifically for this reason. A VRA, because it is nominally a voluntary action by the exporting country, is not subject to the injury tests of escape-clause cases and does not require compensation of the exporting country. The president was later quite defensive about the auto VRA, stating that this was a unilateral action by the Government of Japan, but this rationalization was disingenuous at best. A few weeks after I joined the CEA, the administration had arranged for a measure for which I had been fired for opposing only nine months previously. My return on Washington proved to be a hard landing (Niskanen 1988, 139-140).

If we revisit Figure 3, we can change the title of the graph to the Automotive Market in the USA, and the shift-back in Supply is the Voluntary Restraint Agreement (VRA) the Reagan Administration negotiated with the Japanese government as described by Niskanen in the extended quotation above. The VRAs were finally removed in 1994. Niskanen finds that the main 'winners' of the VRA period were domestic labor unions and Japanese auto-manufacturers. The 'losers' of course are U.S. automotive consumers (Niskanen 1988, 140).[12] Today it is 'domestic content requirements' which have replaced VRAs in rent-seeking for the auto unions. Niskanen summarizes his four years with the Reagan administration regarding trade policy.

> Trade policy in the Reagan Administration is best described as a strategic retreat. The consistent goal of the president was free trade, both in the United States and abroad. In response to domestic political pressure, however, the administration imposed more new restraints on trade than any administration since Hoover. A strategic retreat is regarded as the most difficult military maneuver and may be better than the most likely alternative, but it is not a satisfactory outcome (Niskanen 1988, 137).

After leaving the Reagan Administration Niskanen served as Chairman of the Cato Institute until his death in 2011. In 2008 he published *Reflections of a Political Economist.*

> I have been privileged to serve as the chairman of the Cato Institute since April 1985, following four years as a member and acting chairman of the Council of Economic Advisors under President Reagan. My Cato position involves a variety of responsibilities and is the longest that I have served in any position. I am now 75 years old. So the selection of papers in this book probably represents the focus, diversity, and quality of anything I might write in the future.
>
> The past 10 years have been a very productive period, both for Cato and for me. Cato has developed into one of the nation's most effective policy institutes and has maintained a consistent commitment to the principles of individual liberty, free markets, limited government, and peace – principles that have led us to be increasingly critical of the Bush administration and congressional Republicans. The sad prospect is that these same principles will probably lead us to be increasingly critical of the coming Democratic administration and congressional majority […].[13]
>
> Much of my time during the past two years has been reading and discussion in preparation to write a book on restoring a constitutional federalism in the structure of American government. For the moment I have suspended this effort, primarily because of my increasing pessimism about this prospect. Someday in a more optimistic mood, I expect to return to this task (Niskanen 2008, 1-2).

Summary and Conclusion

We have presented a brief biographical sketch of William Niskanen in order to illustrate that his life as lived is as indeed a case in business ethics. Rent-seeking, political capitalism in our current constitutional order, results in economic welfare loss to society. We have traced the history of the Supply and Demand analysis of rent-seeking to show 1) the transfer of surplus from consumers to those producers with state-granted monopoly power (the Tullock Rectangle) and, 2) the Deadweight Loss to society representing the loss of economic surplus to both

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[12] For a study of the inability of U.S. automakers to compete on quality, and related to the political economy of the subsequent bailouts of 2009, see Weber (2017).

[13] "Oil is Not Worth a War" is presented at Cato eight days before the Gulf War in 1991 and "An Unnecessary War is an Unjust War" is from a television interview with Niskanen by James Woolsey almost a year before Congress gives the Bush Administration the right to invade Iraq in 2002 (Niskanen 2008).

consumers and producers due to the lower quantity being transacted when supply shifts-back while the economy becomes captured during the process of rent-seeking. We have extended the literature on the economic welfare losses due to rent-seeking by bringing-in classical economics to show, 3) the loss in actual standards of-living in addition to the surplus losses which are now part of textbook knowledge, but were not so in Niskanen's time.

> A community is defined by its shared convictions. The dominant shared conviction of the *Reason* community is that the only moral basis for a social order is choice and consent. Choice without consent is meaningless. And consent without choice is the consent of the prisoner. Only a society that is based upon both choice and consent provides the basis for a moral order (Niskanen 1983, starting at 3:20).

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