

**WILLIAM S. VICKREY
1914-1996**

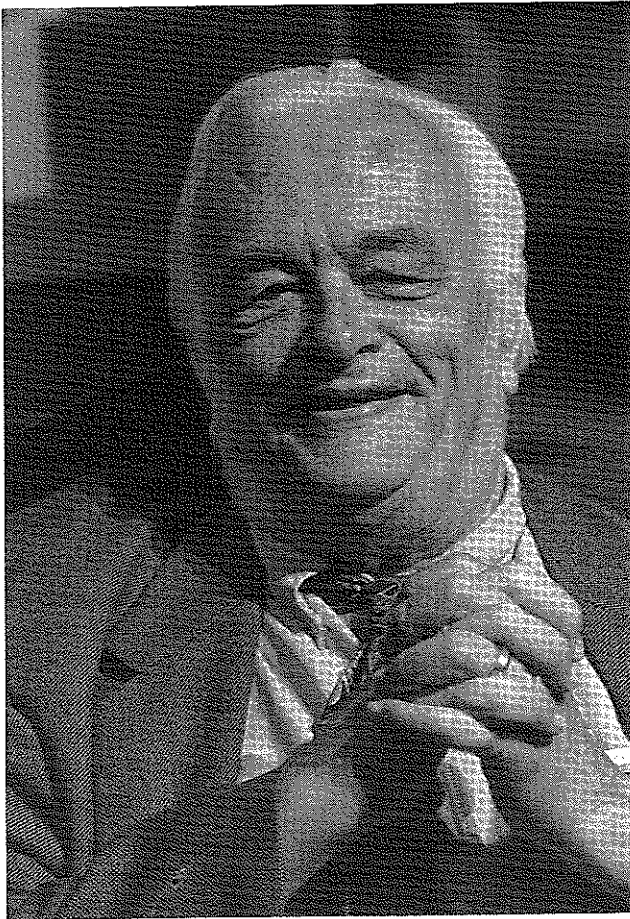


Photo: Columbia University Office of Public Affairs

**WILLIAM VICKREY'S LEGACY:
INNOVATIVE POLICIES FOR
SOCIAL CONCERNS**

Richard P.F. Holt
Southern Oregon University,

David C. Colander
Middlebury College,

David A. Kennett
Vassar College

and

J. Barkley Rosser, Jr.
James Madison University

Every year you would see him hanging around at the Eastern Economic Association meetings. He often seemed rather disheveled and somewhat sleepy, the image of a kindly but absent-minded professor whom one should not take too seriously. A man who could be mistaken for a homeless person, as one press report put it upon his receiving the Nobel Prize. Needless to say, the surface appearance of Bill Vickrey was deceiving. Behind those rumpled clothes of his was a brilliant man.

Bill Vickrey was a Quaker, a pacifist, and a moral economist. He lived economics and spent his life figuring out ways of applying economic reasoning to improve the general welfare. This involved the reduction of complicated ideas into practical policies that could be implemented. Vickrey was no mere theoretician dreaming up vain utopias in the sky. He was very much concerned with improving the lot of his fellow human beings and wanted, above all, to propose policies that could actually work to achieve socially desirable goals. It was this desire that led him, even at an advanced age, to attend so many professional meetings and seminars. It was in the pursuit of such an effort that he died while driving to a conference.

Despite their practical bent, few of Vickrey's policies were implemented. In large part this was due to Vickrey's lack of political sensibility. This was often embarrassing to the economic mainstream, but for Vickrey it was an enormous asset. It allowed him to view economic issues from a perspective of pure theory, not in terms of what was possible, and from the perspective of what he felt was morally right. Hence, he could develop economic ideas, and see implications of arguments that other economists with more political sensibility could not. His work on auction markets, social welfare, optimal pricing, and progressive taxation all fell within that mold. Much of it was 20 to 50 years ahead of its time (There is an adage in the economics profession

that if you think you have a new idea, be careful, because if you search the literature, you will likely find that Vickrey had not only already developed it earlier, but that he has developed it better.)

Vickrey's eccentric behavior was somewhat difficult for many people to understand, even within the generally tolerant and heterodox arena of the Eastern Economic Association. However it must be recognized that Vickrey did receive recognition from the economics profession as a whole, both by his election as President of the American Economic Association as well as his ultimate receipt of the Nobel Prize, even if the latter was for his discovery of the concept of asymmetric information, which he dismissed as of little ultimate interest.

There are many wonderful Vickrey stories. Here is one from Max Sawicky at the Economic Policy Institute:

My best Vickrey story comes from a tax meeting a couple of years ago. He was sitting alone down in front doing a crossword puzzle while corporate types babbled tediously about the international aspects of the federal corporate income tax. When questions and answers time came, he gets up in his gruff voice and says, "Don't you think you're just rearranging deck chairs on the Titanic?"

Vickrey was notorious for appearing to be asleep during EEA sessions, but he was always capable of asking a penetrating question that would put everybody in the room to shame. Furthermore, he was selective in the sessions that he would attend. They were often ones that had small audiences, but involved innovative ideas. More than once he would attend a session where he was the only person in the audience.

Vickrey's greatest contribution to learning was not through the classroom. His teaching style was somewhat vague, his lectures rather rambling. But he did have a brilliant ability to reduce complex models to their simplest elements. In tutorials these insights, and his great warmth, were more apparent. His comments were always helpful, though getting an annotated draft returned was often like pulling teeth. He did not care much for the academic game of getting "maximum mileage" out of his ideas through publication. If he had, he would have won the Nobel prize long before, but it was the idea itself that was always the most important. However, those who studied his work closely could learn much. His writing, like his speech, was littered with insights, real gems that others picked up or later discovered for themselves. After some refinement and nailing down, entire careers were based on his casual remarks or footnotes. The Nobel Committee recognized that "almost in passing, he interposes deep insights in seemingly routine economic arguments." Consequently some of his greatest contributions went unrecognized long after they were written. It would be impossible to adequately review all of Vickrey's professional writings here, but a brief review will give one a sense of Vickrey's intellectual breadth.

CONGESTION PRICING

Although Bill Vickrey believed in government's role as a provider of goods and infrastructure, he was frustrated by public-pricing policies that failed to provide any incentives for citizens to use such resources efficiently. Any graduate of Economics 101 knows that the efficient use of resources requires that consumers pay the marginal social cost. Competitive markets tend to produce an outcome in which price is equal to private marginal cost, and in the absence of significant external costs (like pollution) or benefits (spillovers) imposed on third parties, this is efficient. Vickrey believed that the same principles of marginal cost pricing should be applied in the public sector, but was aware that here the problems of externalities tend to be greater.

This was especially true in the fields of urban and transportation economics, where one individual's use of facilities can impose substantial congestion costs on others. Because these costs vary by time of day, pricing that provides incentives to avoid the peaks promotes a much more efficient use of resources. Some 40 of his papers and reports address the issue of efficient pricing of public services. These not only embody major theoretical contributions but also suggestions of how technology might be used to give practical significance to his ideas.

It is important to understand that Vickrey's pricing proposals are fundamentally different from the current refrain that public sector facilities should 'pay for themselves.' The fees that he advocated are a means of furthering efficiency, not of balancing the books. Public sector deficits did not concern him a great deal, whereas the pursuit of social well-being did. This can be seen by Vickrey's awareness of the interrelationships between the system of urban transport, the pattern of urban development and land use, and the social consequences arising from and associated with these policies. For example, a balance in urban transportation policy more oriented toward subways rather than automobiles would imply a more centralized pattern of urban land use and reduce urban sprawl and its accompanying racial and social alienation. His concern for dealing with slums and urban poverty were driving forces behind not only his proposals regarding urban transportation, but many of his views on taxation.

TAX REFORM

Much of Vickrey's earliest work concerned tax reform. His 1947 Ph.D. dissertation, *Agenda for Progressive Taxation* [Vickrey, 1947], was a tour de force published at the time and ultimately reprinted in Augustus Kelley's Reprints of Classics Series. In this work he advanced 21 suggestions for increasing the simplicity, consistency and equity of the tax code. Only one became law. In the *Agenda* he devoted most attention to a fundamental problem of progressive tax regimes: fluctuating income streams are taxed more heavily than steady ones, which is both unfair and inefficient. It was a great disappointment to him that his solution, "cumulative lifetime

income averaging," was ignored. Again the opposition chose to characterize the innovative as alien and overly complex. Ironically the congressional authors of an increasingly arcane, inequitable and administratively burdensome tax system resisted cumulative averaging of the grounds that it required too much paperwork.

AUCTIONS

The Nobel Committee particularly admired Vickrey's work on how governments should allocate rights like oil-exploration licenses or radio bands. His contribution was (like much of his work) insightful, useful, and deceptively simple, and it went largely unrecognized until theorists found that their 'results' had been documented long before. In his 1961 article "Counterspeculation, Auctions, and Competitive Sealed Tenders" [Vickrey, 1961] he arrived at the conclusion that while sealed bids were an appropriate device, the right should be awarded to the highest bidder, but at the second-highest offer price. This would ensure that the right went to the user who valued it most, and efficiency dictated that the price should equal the opportunity cost, denoted by the second bidder's valuation. This has come to be known as a 'Vickrey auction' and was one of the ideas seen as an early application of asymmetric information for which he was awarded the Nobel Prize.

INFLATION VS. UNEMPLOYMENT

While most of Vickrey's career had been spent advancing ways to decrease waste through creative pricing, toward the end of his life the unemployment issue came to dominate his thinking and research. This part of his work, his challenge to the current neo-conservative orthodoxy, seemed to have been overlooked by the Nobel Committee.

Vickrey traced the profession's views of full employment through a series of developments whereby macroeconomists increasingly turned from full employment to stable prices as the dominant policy goal. This started in the 1960s when A. C. Phillips brought attention to the "trade-off" between inflation and unemployment; Phillips noted that when unemployment was reduced, perhaps as a result of stimulative fiscal policy, heightened demand in both labor and goods markets tends to lead to price rises. The existence of a trade-off is in itself an unobjectionable observation. The controversy arises over the weights that should be assigned to the two evils. Vickrey was deeply concerned that economists and politicians treated the two as if they were equals, or worse, that price stability was a more laudable goal than full employment.

Inflation's most corrosive impact is caused by uncertainty about price changes. The adverse effects of anticipated inflation can be compensated by creative and thoughtful institutional change. Unemployment on the other hand is an unambiguous loss to society. Output lost as a result of less than full capacity utilization is gone forever. Joblessness contributes to poverty, disease, homelessness, racial antagonism, and crime. Resistance to reducing the military, liberalizing trade and immigration, and controlling pollution (all desiderata in Vickrey's view) is heightened by high levels of unemployment.

Things became more injurious when economists began to hold as being true something called the "non-inflation-accelerating rate of unemployment." This is usually defined as the rate below which unemployment cannot be driven without starting prices on a sustained upward spiral. Government attempts to force unemployment below this level (by, for example, stimulative fiscal policy) lead only to faster rates of price increase. To some this threshold level became known as the "natural rate of unemployment," in Vickrey's eyes "one of the most vicious euphemisms ever." Worse yet, some authors started referring to this as the "full employment rate," implying that society could never sustain lower joblessness.

A comfortable collusion of "mainstream" economists and politicians, strongly influenced by the views of the financial sector, has led in recent years to an acceptance of the goal of keeping inflation below 3 percent and unemployment below 7. Within those limits lay security, and we have lived within them for most of the 1980s and 1990s. The tragedy is that the costs of 7 percent unemployment, or even the 5.0 percent we experience today, are considerable, although generally far removed from those who advocate belt-tightening and fiscal conservatism.

To Vickrey this was anathema. His definition of full employment was about 1.5 percent of the workforce (what in the past we have called the frictional unemployment of people changing jobs), and levels above this he thought to be socially wasteful. Rates of inflation of about 6 percent were to him acceptable, and with the correct combination of fiscal and monetary management and modest institutional reform he believed they could be non-accelerating. Moreover, if the policies required to drastically cut unemployment led under present institutions to accelerating inflation, it was the economist's task to design, and the politician's duty to establish, institutions that could lead to an acceptable rate of inflation, without compromising the prime objective of full employment.

An example of his passion and concern for this issue was seen at the 1996 EEA meeting, where he attended a session on "What is Post Keynesian Economics?" Bill Vickrey was sitting in the front row and occasionally, in the middle of a paper, you would hear him snoring. After a series of papers on money, uncertainty and expectations and methodology, Vickrey's eyes popped open, he jumped up and proceeded to lecture everyone, with Ingrid Rima's support, that he couldn't understand how you can have a session dealing with Keynes and not have a single paper dealing with the evils of unemployment!

Vickrey had a plan for how to change economic institutions to make 2% unemployment compatible with maintaining a market economy. That policy was developed by Vickrey, Abba Lerner and David Colander. It was called a market based incomes policy or MAP. Under this policy firms are required to buy the right to raise their value-added adjusted prices from other firms which lowered their value-added adjusted prices by offsetting amounts. The policy eliminates inflation regardless of the level of aggregate demand. It creates a market to solve a market problem. Because it is a market plan, it allows individual firms to set whatever price they want subject to the rules of the new imposed market. Vickrey recognized the technical problems with MAP, but he believed that it was viable plan, and much of his recent work was designed to make the idea practical and politically acceptable.

Though his macro policy views were important to Vickrey, they seem to have been downplayed by the profession when he was awarded the Nobel Prize. His views on macroeconomics were too far from the mainstream to be acceptable. Had he lived, the suppression of his latest ideas would not have succeeded; Vickrey fully intended to use his new found fame as a bully pulpit for his ideas. The thought of this was, we suspect, embarrassing for some in the profession. When, for example, Vickrey gave his presidential address espousing his new ideas to the American Economic Association a few years ago, David Colander remembers seeing a couple of young economists shifting with embarrassment in their seats. One asked the other: "Is this guy for real?" Vickrey was very real and a great economist, who carried out the logic of economic ideas without concern about political sensibility.

Vickrey's approach to economics was that you must first determine what results are morally justifiable, and then design institutions to achieve them. Currently, most of the profession approaches economics from the opposite direction; they determine what is achievable, and define that as morally justifiable. Of the two approaches, Vickrey's is, in our minds, the more reasonable. We, and the Eastern Economic Association, will miss him dearly.

REFERENCES

Vickrey, W. *An Agenda for Progressive Taxation*. New York: Ronald Press, 1947.

_____. Counterspeculation, Auctions, and Competitive Tenders. *Journal of Finance*, 1961, 8-37.