ECONOMIC BRIEF NO. 31

Policies Can Bring Surprise Results

This series of economic briefs explores fundamental concepts in economics and community and economic development.

One of the more obscure but interesting laws of economics is the law of unintended consequences, which suggests that economic policies often have an impact different from that which was intended. This outcome is most likely to show up only in the long run.

Consider Social Security, for example. Its purpose was to relieve poverty among the elderly, which it has done with splendid success. But it has also reduced private saving for retirement and work effort by people aged 62 and over—two unintended consequences. Or think about the many small towns in South Carolina that strictly enforce their rather low speed limits as a revenue source. As a consequence, people avoid known speed traps. Insurance rates in South Carolina are also driven higher, when excessive numbers of speeding tickets are written.

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Unintended consequences flow from the many state programs to provide scholarships to good students—those with high SAT scores and/or good grades. These scholarships make college education more affordable and encourage good students to attend in-state colleges. But think about the other effects. First, it's easier for colleges to raise tuition, knowing that it won't have an impact on good students. But higher tuition does place a burden on the average or marginal student. Second, each state tries to keep its best students at home, so it's not clear that any state is improving the quality of its student body, but just making it narrower in terms of where students come from. Third, the scholarships may cause more grade inflation in both high school and college or more resources to be expended on improving SAT scores. Finally, it's likely that the lower college costs will induce more high school students to go to college, so financial outlays for the program will be higher than anticipated.

The law of unintended consequences is the result of two basic facts about how people think and how policy is made. First, not too many people respond immediately to new policies, because habit and commitment are hard to change. But as people become aware of the choices and options they face, whether it is retirement benefits, speed traps, or college scholarships, they gradually change their behavior. They retire early, find alternate routes, or rethink their education plans. So the long-term effects are almost always different than the short-term effects. Second, policy makers tend to ignore secondary market effects. They may think about the direct effects of property tax relief for homeowners on tax burdens, but may not work through the equally important indirect effects of property tax relief on real estate prices or on the mix of owner-occupied and rental property.

Just because a program has unintended, but often foreseeable, consequences doesn't mean it shouldn't be put in place. It does mean that programs require careful and thoughtful design and a weighing of whether the expected benefits are worth the expected costs, including the unintended consequences.