Economics and Politics: On Narrowing the Gap

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Being here on this podium today is a double honor for me. First, the prize is named after Pat Moynihan, whom I knew personally, but much more importantly, who was the U.S. Senate's house intellectual for many years. I've long thought the Senate needs *one* house intellectual, an unofficial post that has been vacant since Moynihan's departure. I am thrilled to win the prize and to deliver this lecture in his memory.

Second, I am deeply honored to join the impressive list of past recipients, which includes my earliest mentor in the world of policy, Alice Rivlin; three former co-authors, Becky Blank, who sadly passed away earlier this year, Alan Krueger, and Joe Stiglitz; and true legends like Paul Volcker, Marian Wright Edelman, and Bob Greenstein. To flip the script on Groucho Marx: I am honored to join any club that has Paul Volcker and the others as members.

The two civilizations

The Academy's website says the Moynihan prize was designed "to recognize social scientists, public officials, and civic leaders who champion the use of informed judgment to advance the public good." So I thought it appropriate to revisit a theme I have written about before: the chronic clash between sound economics and good politics.[1] Doing so typically leads to much hand-wringing. After all, the chasm is wide, and promoting sensible economic policies in a political world is a recipe for frustration. I'll do only a little of that hand-wringing today. My focus is on what we might do to shrink—not *eliminate*, just *shrink*—the yawning gap between good economics and good politics.

May I start by dispelling a myth? Perhaps because economists are frequently trotted out to support or oppose policies, perhaps because we have a Council of Economic Advisers right in the White House, perhaps because the powerful Federal Reserve—so ably represented here today--is dominated by economic thinking, many people believe that economists have enormous influence on public policy. In truth, apart from monetary policy, we don't.

[1] Alan S. Blinder, *Hard Heads, Soft Hearts: Tough Minded Economics for a Just Society*, 1987; Alan S. Blinder, *Advice and Dissent: Why America Suffers When Economics and Politics Collide*, 2018.

Almost a half century ago, George Stigler (1976, p. 351), later a Nobel prize winner, wrote that "economists exert a minor and scarcely detectable influence on the societies in which they live."[2] Stigler was no doubt exaggerating to make his point. But he had a point. And things have not changed much since.

In a book I published five years ago (Blinder, 2018), I argued that economic policymaking often follows The Lamppost Theory: Politicians use economics the way a drunk uses a lamppost—for *support*, not for *illumination*.[3] I explained that economists and politicos—by which I mean not only politicians, but the entire entourage of advisers and message meisters that surround them—hail from entirely different civilizations. They view the world differently. They speak different languages. They define success differently. They have dramatically different time horizons. They even employ different forms of logic.

I once thought "political logic" is an oxymoron. Many economists still do. Isn't politics nutty? Isn't there only one logic, handed down from Aristotle? No. I've learned there is a *logic* in politics that I'll illustrate with a trivially simple arithmetical example.

Imagine a policy--say, a tax break--that would reap $1 million in gains for each of ten people but cost 20 million people $1 apiece. *Economic* logic clearly counts this a bad policy. To pursue it, there would have to be some persuasive *noneconomic* reason.

But *political* logic sees this policy starkly differently. The 20 million losers of a dollar each will not notice their puny losses. And even if they did, the loss is not nearly large enough to move them to political action. The ten million-dollar winners, by contrast, will certainly notice their new-found largesse and be grateful to the politicians who crafted it. The gains *to the politicians*—in terms of support, campaign contributions, and the like—will dwarf any political losses, which are probably negligible. Only the most highly-principled politicians will resist tradeoffs like that.

While this example is trivial, it illustrates a deep and ubiquitous problem: why so many policy decisions seem wrong to economists, not just in tax policy, but also in trade policy, regulation, antitrust, and a host of other areas. It would not help much, by the way, if politicos understood economics better. Economic logic and political logic just often point in opposite directions. It's a fact of life.

Can we bring the two civilizations closer together? Moving the politicos

Politicos and economists will never look, think, and speak alike. If you want to understand why, ask Charles Darwin. But can we at least shrink the gap? Can we get politicos to put a bit more weight on the economic merits? Can we get economists to understand the political world a bit better? I *think*—or maybe it's that I *hope*—we can. I am not naïve about this. I realize it will

[2] George J. Stigler, "Do Economists Matter?" *Southern Economic Journal* 42, no. 3 (1976): 347–354, p. 351. https://doi.org/10.2307/1056613
[3] Alan S. Blinder, *Advice and Dissent: Why America Suffers When Economics and Politics Collide*, 2018.

be hard and that economists must do more of the changing. So in my remaining time, I'd like to offer one suggested change for politicos and two for economists.[4]

It is a commonplace that politicians have excruciatingly short time horizons. It is often said that they can't see past the next election, but the truth is far worse. The political pros who advise politicians often can't see past the next public opinion poll, maybe not even past the next tweet. Their natural time horizon extends only until that evening's news broadcasts, if that long.

But getting politicians to think longer term may not be as hopeless as it seems. Suspend disbelief for a moment, and suppose behaving as if there is an election every Tuesday is not as smart politically as many politicos seem to believe. Then sound economic policy at least has a chance. After all, politicians are among the most adaptable of God's creatures. If they can be persuaded that current political habits are counterproductive, they may change their ways—not due to a sudden burst of idealism, but because they want to win elections.

To be concrete, let's focus on a newly-elected president who, regardless of the framers' intent, generally takes the lead in proposing and promoting policies. One fortunate fact is that the president's four-year term is long enough for the major effects of most (not all) economic policies to be felt. So sound economic policies enacted during, say, the president's first two years are likely to have shown major benefits before the next presidential election. Within that window, good economics can also be good politics.

Of course, this salutary coincidence in time shrinks as the president's term progresses. But that's where America's crazy electoral calendar comes to the rescue. Once we've passed the 18-month mark of a new presidency, attention turns to the midterm elections. And after that, midterm losses typically make it hard for the president's party to push *any* major initiatives through Congress. Besides, at that point all political minds turn away from policy and toward the next presidential election. Put all that together, and you see that the policy phase of a new presidential term rarely lasts more than 18 months. During that brief period, economic and political time horizons arguably dovetail.

President Biden's economic policies illustrate this timing exceptionally well. He managed to get a raft of major policy initiatives through Congress in 2021 and 2022, but not since.[5] Now, with his polling numbers still low, he is banking on the positive results of these policies to aid his reelection. By the way, he certainly viewed these initiatives as good for society as well.

Can we bring the two civilizations closer together? Moving the economists

Let me now turn to the minority of economists who wish to get engaged in policy. I have two suggestions to offer here—and many more elsewhere.[6] Both suggestions cut deeply against the grain. They are *not* what we teach in graduate school.

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[4] I will offer more examples of each in a forthcoming essay for *The Annals of the American Academy of Political and Social Science*.

[5] Avoiding a disastrous collision with the national debt ceiling was a major *politica*l achievement in 2023. But economically, that was mainly about preserving previous initiatives.

[6] See my forthcoming article in *The Annals of the American Academy of Political and Social Science*.

The first pertains to those time horizons again. I have just emphasized that *political* time horizons are *too short* for sound economic policy. But it's also true that *economists'* time horizons are *too long* for politics.

Specifically, we economists typically focus on the "equilibrium" or "steady state" effects of a policy change. For example: What will happen *eventually* after a change in the tax code or a trade agreement? Don't get me wrong. Those questions are important and highly pertinent to policymaking. We should not forget about them. But they are close to irrelevant in the political world because people don't live in equilibrium states. Rather, they spend most of their lives in one *transition* or another. Yet economists often brush off "transition costs" as unimportant details. We shouldn't.

Trade agreements are a good example. With some exceptions, trade theory compares one full-employment, steady-state equilibrium with another. David Ricardo taught us over 200 years ago that the free-trade equilibrium is better for society as a whole (although not necessarily better for every person in society) than the equilibrium with trade protection. He was right, which is why almost all economists are free traders at heart.

But wait. The process of *adjustment* to the superior free-trade equilibrium may be lengthy and painful, involving job losses, reduced incomes for some, decimated communities, and more. Economists know all this but don't pay it sufficient heed. Politicians, by contrast, live in the real world of ever-present transition costs. They may not be in office long enough to enjoy the steady-state benefits.[7]

Now, I am not suggesting that economists embrace protectionism. Far from it. I use the trade example to argue a general point: that economists should spend a lot more time and effort thinking about possibly painful transition costs, and how to mitigate them, rather than focusing hyperopically on steady state effects.

My second suggestion is that economists pay far more attention to issues of *fairness* rather than doting almost exclusively on *efficiency*, as we often do. In politics, perceived fairness almost always trumps efficiency—and politicians understand that. Which is one reason why economic policy is often so manifestly inefficient. In saying this, I risk losing my economists' license. We do, after all, worship at the altar of efficiency for a reason: greater efficiency enlarges the economic pie.

But I hope the economists in the audience will hear me out. I am *not* recommending abandoning efficiency as a guidepost, only that we temper our enthusiasm for efficiency with a bit more respect for political feasibility—which often hinges on perceived fairness.

Think, for example, about debates over the tax code, which are hardy perennials in Congress. Economists have a beautiful theory of optimal taxation, built around maximal

[7] The International Trade Commission's (2016) huge analysis of the ill-fated Trans-Pacific Partnership takes the analysis out 30 years! *Trans-Pacific Partnership Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors* (Investigation No. TPA-105-001, USITC Publication 4607, May 2016). https://www.usitc.gov/publications/332/pub4607.pdf

efficiency.[8] But that theory plays absolutely no role in congressional debates. Zero. Discussions of fairness, on the other hand, dominate the debates. And we get the tax mess that we do.

Climate change offers another example. I have often said that 101 out of every 100 economists think the best approach to limiting CO_2 emissions is a carbon tax. On efficiency grounds, it beats the other remedies hands down.[9] But many politicians recoil against taxes, and many citizens see it as *unfair* to levy higher taxes on people who "must" use a lot of energy.

Virtually every economist will tell you that subsidies, tax breaks, and direct government spending to limit CO_2 emissions are grossly inefficient compared to a carbon tax.[10] But unhappily for us, voters and therefore politicians hate the idea. In the United States at least, taxes on carbon emissions have negligible political support. So what are we economists to do? Withdraw as a matter of principle from what is probably the most existential economic problem facing the human race? Bay at the moon, even though no one is listening?

No. I think there is a better way, and the misnamed Inflation Reduction Act is an example. While it does little to reduce inflation, it does promise sizable reductions in America's CO_2 emissions. Society is almost certainly better off with it than without it, even though it has no carbon tax and accomplishes the reduction in carbon emissions inefficiently. Most important of all, however, President Biden was able to push it through Congress, albeit on a straight party line vote, when a carbon tax would have failed.

So here's my advice to economists interested in actual--as opposed to theoretical--policymaking. Don't forget about efficiency. It matters. We are right about that. But we may have to content ourselves with nibbling around the edges, below the political headline level, to make the *details* of a complex policy package *less in*efficient. Call it the theory of the third or fourth best.

Wrapping up

There is much more to say about moving politicos and economists closer together--without resorting to pie-in-the-sky thinking. But I have overstayed my time. Admittedly, it's a long shot. And movement, if it comes, will be slow and grudging. But the potential rewards are great.

Having opened with Groucho Marx, let me close with Yogi Berra, who once observed that, "In theory, there is no difference between theory and practice. In practice, there is."[11]

Thank you for listening.

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[8] The seminal contributions were Peter A. Diamond and James A. Mirrlees, "Optimal Taxation and Public Production I: Production Efficiency," *American Economic Review* 61, no. 1 (March 1971): 8–27; and Peter A. Diamond and James A. Mirrlees, "Optimal Taxation and Public Production II: Tax Rules," *American Economic Review* 61, no. 3, part 1 (June 1971): 261–278. The optimal taxation literature since then is vast.
[9] See, among many others, Gilbert E. Metcalf, "On the Economics of a Carbon Tax for the United States," *Brookings Papers on Economic Activity,* Spring 2019: 405–458.
[10] In a Clark Center/Chicago Booth poll of experts, 90% agreed or strongly agreed that: "A tax on the carbon content of fuels would be a less expensive way to reduce carbon-dioxide emissions than would a collection of policies such as 'corporate average fuel economy' requirements for automobiles." See https://www.kentclarkcenter.org/surveys/carbon-tax/
[11] See https://www.brainyquote.com/quotes/yogi_berra_141506