In Defense of the Dismal Science

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Extended version of prepared remarks

I am deeply honored to be giving the second Richard Cooper Lecture. I first met Dick through his writings. Dick was a must read on everything from exchange rate regimes to climate for anyone concerned with economic issues and interested in straddling the worlds of academia and public policy. I then had the privilege of getting to know Dick in person and become friends with him when my family moved next door to him in Cambridge. Sitting in his living room talking to him about the books he was reviewing for *Foreign Affairs*—hundreds of which were stacked perilously around his living room—or discussing my latest *Wall Street Journal* column was always interesting and challenging. My family has also had the good fortune to become good friends with his wife Jin who is also a regular participant in seminars in the economics department at Harvard and a thoughtful economic thinker in her own right. I want to thank Jin for supporting this lecture series and my presence here today.

I want to begin with a disclaimer. The U.S. Presidential election is 38 days away and as a non-profit the Peterson Institute for International Economics (PIIE) is resolutely nonpartisan. I, however, am going to be partisan. Possibly even rapidly partisan. I can see PIIE President Adam Posen starting to look nervous so let me be clear—I intend to be a partisan not for either political party but for the dismal science itself. I will argue that economics has been misunderstood—both by some of its proponents and its many detractors—and is not nearly as dismal as you might think. But that it does ask us to take tradeoffs seriously—but this too is good, a way to give voice to the people that would otherwise be voiceless in a policy process often dominated by special interests.

Defending the dismal science may seem unnecessary. Economics still has enormous prestige and influence. I have the privilege of co-teaching nearly half of the students who go through Harvard College a mainstream, modern approach to economics (more on why I say "modern" in a moment) while the seminar on socialism taught by a heterodox professor has only a handful of students. The biggest macroeconomic decisions are made at central banks around the world that are staffed by PhD economists and approach issues through a conventional set of macroeconomic models. The International Monetary Fund (IMF) and World Bank also approach

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issues in a similar spirit. Cost-benefit analysis has long been governed by a string of executive orders that require cost-benefit analysis and the antitrust enforcers do detailed economic analyses. Mainstream economists are frequently quoted in the media.

Moreover, economics does not know the answer to every question and economists make mistakes—I certainly have had my share of calls that, at least in retrospect, were wrong.

Nevertheless, there is an increased attempt to either articulate an alternative set of approaches to mainstream, modern economics that sometimes goes by the name of "post neoliberalism" or to reject the role of expertise altogether in the name of "populism". Much of this can be a rejection of tradeoffs and an associated skepticism of budget constraints, cost-benefit analysis and other types of analysis, a belief that over-fetishizing them has halted progress. Numerous books have been written in recent years blaming economists and so-called "neoliberalism" for everything that has gone wrong and their rhetoric has influenced the way economic policies have been sold and in some cases how they have been developed. The alternative strand of populism is based less on books and articles and more on a set of raw instincts and political arguments but there has been some attempt at codifying it and in its extremes there can even be overlap between the so-called post-neoliberal approach and populism around issues like antitrust and trade.

This new set of ideas are still not dominant, nor are they a fully coherent alternative—in many cases they are more situational and political than anything else. In many cases they lead to policy recommendations I might support but the reasons you do something and how you explain it matter because they help to shape how you make decisions in the future. Teachers take points off for getting the answer right but the work wrong for good reason. As a result, I thought it was important to articulate a defense of the dismal science.

How the Dismal Science Got Its Name

I want to start by telling you how the dismal science got its name. The term was coined as an epithet by the historian Thomas Carlyle in 1849 in an essay, "Occasional Discourse on the Negro Question." Carlyle's essay was advocating for the reinstitution of slavery in the Caribbean. He was upset that economists like John Stuart Mill were against this idea, complaining about them "declaring that negro and white are… on a footing of perfect equality, and subject to no law but that of supply and demand according to the Dismal Science."

Political economists at the time treated people as equal. Carlyle viewed the economic state of Black people in the Caribbean as a reflection of his deeply racist belief in their subhuman status. Mill offered an alternative, arguing that all people were governed by the same forces of supply and demand—and given equal conditions believed that anyone could thrive.

It is no accident that Mill, Jeremy Bentham and others were also strong and early proponents of universal education, women's suffrage and equal rights to work, what we would now call LGBT rights along with a belief in the centrality of markets and limits on the government's role in the economy.

These economists were not just basing their conclusions on their positive analysis but also their commitment to utilitarianism, considering how policies affected all people—and giving more weight to the least fortunate in that calculus. This is a particular moral philosophy that not all economists share but it is not an accident that a positive theory that focuses on individual utility maximization and helps analyze the consequences of policies for people would also have an affinity this form of utilitarianism.

I share all of this not because one of the arguments against the "dismal science" is that it is lends itself to analysts supporting minimal changes or outright conservative opposition to them. This is not where economics started and not where it is today.

Saving the Dismal Science from Both Some of Its Defenders and Its Critics

I sometimes think that economics needs to be saved both from some of its defenders as well as its critics. Both sides believe in a narrow caricature of economics 101 that may have been relevant 150 years ago (although I doubt it was). According to both these defenders and critics "economics says" or "econ 101 says" with the conclusion being no government or free markets. Of course, economics does not say anything—there are a variety of positive conclusions and moreover none of these can give you an answer without being combined with normative views.

Over the last 150 years economists have developed and fleshed out ideas including externalities, imperfect competition, game theory, imperfect information and behavioral considerations. These are not just topics of advanced economics courses, roughly half the space in Greg Mankiw's introductory microeconomics textbook is devoted to them. Moreover, many of these theoretical considerations lead to ambiguous predictions which has occasioned a shift from theory to empiricism in economics.

In my introductory class (Ec10, not Econ 101) we devote equal time to the competitive and institutional models of the labor market and integrate behavioral considerations in from almost the very start of class. In both cases that leads us to focus on empiricism. For example, some models predict the minimum wage reduces employment, others predict it increases it, theory cannot settle the question so you need to go to the data.

Economists working on industrial policy have identified many more ways in which abuses of market power can have pernicious effects than the over-simplification of economic research that Robert Bork used to motivate the Chicago School of antitrust.

Economists consider multiple goals not just GDP and journals are filled with articles about climate change, inequality, and hopefully will get more articles on other goals that motivate policymakers like national security.

Empiricism has even identified numerous candidates for free lunches in economics, like Medicaid expansions for children in the United States or deworming treatments in Kenya, that some studies have found pay for themselves in present value by increasing work and earnings—and thus tax revenue—for the beneficiaries later in their lives.

But it is fair to say that economics is stingy about its free lunches, the topic I will turn to next.

Economics is Stingy About Free Lunches

Consider Lionel Robbins' classic definition of economics as "the science which studies human behavior as a relationship between ends and scarce means which have alternative uses". Without scarcity our choices would all be easy—we would not worry about what to buy or how to allocate our time. Public policy would also be easy if everyone could have everything they wanted.

The plural "ends" in this definition is also critical. As individuals we do not just want more money we also want more time with family. As policymakers, we do not just want more GDP we also want less poverty and climate change. In some cases these go together, more GDP might lead to less poverty. But in other cases there may be tradeoffs between these ends, for example some steps to reduce climate change will also reduce GDP.

Most of the issues studied by economists and most of the most fundamental and difficult choices for society entail tradeoffs. The political system, however, hates tradeoffs. Although politicians occasionally demonize some groups, more often they like to talk about how their policies will help everyone and everything simultaneously. I have some patience for political rhetoric that may not be completely analytically founded but the bigger and less forgivable problem is when policy analysts contort themselves into providing support for this way of thinking.

The way in which this happens often varies between liberals and conservatives. I am going to overgeneralize in describing what I call the "liberal vice" and "conservative vice" in policy analysis. But disclaimer: many liberals and conservatives do not suffer from these vices and moreover some liberals suffer from the conservative vice and vice versa.

The Liberal Vice: Getting the Sign Wrong When Arguing that All Good Things Go Together

The liberal vice involves getting the sign wrong when arguing that all good things go together. More specifically, it is usually that advancing some non-economic objective like climate change or inequality or national security will also advance economic objectives like GDP growth or job creation.

What is wrong with the liberal vice? Climate change, inequality, health and national security are all worthwhile goals. They often face political obstacles. What is wrong with adding some economic arguments to make these good things happen? It is certainly something I have been happy to do, for example making arguments about expanded immigration being good for economic growth (something for which there is very strong evidence, but it still is not the most important reason I personally support expanded immigration).

There are three problems with indulging the liberal vice.

<u>The first is that if you do the analysis right you will end up ruling out many policies you should support</u>. Take the idea of inclusive growth, the idea that reducing inequality and increasing inclusion will boost economic growth. A number of win-win policies probably do fall under that heading, like expanding Medicaid for children, and we should be pursuing all of those. Economists have rigorously documented some policies where the marginal value of public funds may be infinity, which is to say that the a beneficial policy also pays for itself.

But we should not stop there. Economic growth per capita is a specific moral metric and not one most of us, even conservatives, would defend on first principles. It is measured by taking the mean of incomes and then calculating their growth rate. This implicitly says that $1 is as valuable in the hands of a billionaire as it is for a person struggling to get by. Personally I am more focused on the well-being of the poor or the middle class or some utilitarian concept like the mean of log incomes.

And if that is what you care about you should not stop at policies that both increase growth and reduce inequality, you will also want some policies that reduce inequality at some cost to growth—like higher taxes on high-income households to pay for expanded transfers or investments for poor workers or the middle class which can result in better outcomes for the poor or even the majority of people even if they result in lower average income across all people.

<u>The second is that you, in fact, often get the analysis wrong</u>. The more common problem is not that people who commit the liberal vice rule *out* too many policies because they reject anything with a tradeoff. Instead they are more likely to rule these policies *in* by getting the analysis wrong and denying the tradeoffs. People suffering from the liberal vice can be tempted to think that companies systematically make mistakes that, if corrected, would advance whatever other goals they have—whether it would be higher pay, greater energy conservation, or increased diversity.

In some cases the consequences of mistakenly assuming away tradeoffs is fine. In my own view, not much harm comes from ignoring the small macroeconomic downsides of small increases in top marginal tax rates and a lot substantive good can come from policies to raise these rates.

But there are many other cases where failing to think seriously about tradeoffs can be more harmful. When people claim that domestic content requirements for car batteries can help reduce carbon emissions or that unlimited fiscal stimulus will not have any effect on inflation you can end up with bad outcomes. And in some cases, like the belief that schools could be shutdown during the pandemic without any learning loss, the consequences of the analytic error that all good things to together are truly tragic.

It can be tempting to, for example, pursue regulatory approaches to reducing carbon emissions without considering the costs these might impose on working families or how they might be mitigated, an error that is much less likely if you are considering a carbon tax.

<u>The third problem with the liberal vice is it may get in the way of achieving your goals</u>. If you think all good things go together you will not be able to anticipate and either compensate for or overcome the fact that the policy may really have losers whose objections can actually stop it. For example, when I was in the White House one staffer on my team told me that a particular regulation would increase predictability for corporations and help them as well as protecting consumers. The day it was released one of the main objects of the regulation saw a sharp drop in its stock price. That does not mean the regulation was bad for society but it does suggest that the impartial judgement of the market disagreed with the staffer's assessment. And that company was eventually able to lobby to get the regulation undone.

In general, many policies are resisted not because people do not understand them but because they do understand them—and they understand the ways in which they are hurt by them. Understanding that and addressing it either through compensation or a political strategy to overcome the objections is essential.

In sum, the liberal vice often involves getting the sign wrong—assuming that something that might be bad, possibly even mildly bad, for the economy will actually be good for it.

The Conservative Vice: Getting the Magnitude Wrong Or Arguing Only One Thing Matters

Let me now introduce the conservative vice which can be understood as getting the magnitudes wrong. You hear it whenever someone argues that we should avoid clean energy policies because they will kill the economy or that Boeing's efforts to recruit a more diverse workforce caused the Boeing 737 MAX crashes, an assertion that Elon Musk appears to have endorsed. These are examples of getting the magnitude badly wrong.

Once again, not all conservatives suffer from the conservative vice. And not only conservatives suffer from it. But I think it is common enough that it is a useful construct to discuss. And it has three problems that mirror the three problems of the liberal vice:

<u>First, policymaking suffering from the conservative vice will miss significant policy opportunities</u>. If we care about goals other than the economy—and most of us do—then we should pursue some steps to address them even if they come at some cost for all of the reasons I have been discussing. If we are not willing to spend even a penny to improve climate change or health care we are almost certainly making a mistake.

<u>Second, the conservative vice will often drive people to bad and biased analysis</u>. It is easy to just care about growth if you explicitly reject caring about anything else like poverty or climate change. But that is a hard stance to defend. So it is more common to get the analysis wrong. We all have heard rhetorically vivid overstatements about tax increases on the affluent,

regulations, and other policy measures "destroying" the economy of "killing" jobs. Sometimes these are accompanied by quantitative analyses that go way beyond what any reasonably economic analysis could find.

In other cases we hear overstatements of the benefits of growth for other goals, like poverty reduction or climate mitigation. For example, consider a regressive tax cut that increases the level of output by 1 percent after a decade—which is actually a very large estimate for a tax cut. That might mean an extra $200 for a lower-paid worker, which is potentially dwarfed by whatever eventually pays for the tax cut, like reductions in means tested transfers.

<u>Finally, the conservative vice will also fail to anticipate the political obstacles to policies when people actually do care about more than growth—and moreover the growth may not be nearly as large as claimed</u>. To give one example, when she was Prime Minister Liz Truss proposed a set of dramatic tax cuts believing—without any meaningful economic analysis to back her up—that they would dramatically increase economic growth. Her budget proposals, and her Prime Ministership, ended up foundering on the fact that the public also cared about some of the goals her spending cuts would undermine and the impartial judgment of the markets was that her tax cuts would not be nearly as miraculous for growth as she claimed.

Both the Liberal and Conservative Vices Absolve People from Economic Analysis

If all good things go together, as held by the liberal vice, there is no need for cost-benefit analysis. No policy decision depends on how you quantify your benefit-benefit analysis. In this case economics, as discussed in Alan Blinder's book, is more for support of the policy than illumination about whether or not to undertake it.

Similarly, if the effects on growth are so large that they dwarf any benefits, or if you argue there is nothing else in the objective function, then you are left with "cost analysis"—and once again the quantification is not needed to inform decisions but to propagandize for what you have already decided. If you believe all tax cuts pay for themselves—without any plausible analysis of the magnitudes of economic and revenue feedback—you can end up supporting some very poorly designed and expensive tax cuts.

In other words, sufferers from the liberal and conservative vices do not have any real need for economics as defined by Lionel Robbins, "the science which studies human behavior as a relationship between ends and scarce means which have alternative uses". For the conservative vice there are not ends but a single end, either because it is all that is in the objective function or because the tradeoffs are so severe it dominates the objective function. And for the liberal vice there are no scarce means.

Quickly taking three examples from recent economic policymaking. Domestic content requirements in the climate space will result in higher carbon emissions than if we relied on more efficient imports. I have not seen any attempt to quantify this tradeoff—in fact it is usually denied outright—but it would be hard to convince me that the emissions reductions were worth any gain in domestic manufacturing jobs (and when you consider crowd out, we may not even get additional domestic manufacturing jobs). Similarly, requiring childcare for CHIPS grants probably helps childcare a little while hurting our objective technological resilience a little, making that policy a mistake—albeit a small and likely inconsequential one. On the other hand, the set of restrictions on exports and technology transfers of chips to China probably does hurt U.S. growth but in a way that is a reasonable tradeoff for the national security benefits we get from this policy—the middle class will have to pay a little more but in the end it is likely to be worthwhile.

One Corollary: If Your Policies Never Hurt Economic Growth Then You Are Probably Not Doing Enough

In reality we have multiple objectives and policymaking entails tradeoffs between them as all of these examples illustrate. In fact, generally if you are not hurting one objective to advance another you are doing too little.

Let me give the example of the response to the pandemic. The liberal vice was the argument that protecting lives helped the economy—there was no tradeoff. We heard again and again that the way to save the economy was to save lives—and that policies like mandatory shutdowns would be good for the economy over time. During the pandemic the conservative vice was that any non-pharmaceutical interventions would be so costly for the economy they should be avoided.

Both perspectives were wrong. Any reasonable response to the pandemic should have included steps that would have hurt the economy. Claiming that your policy approach, at the margin, helped the economy was an admission that you were doing too little, or more likely that you were doing your analysis badly.

If the pandemic response did not include steps that would hurt the economy then you doing too little to save lives. Claiming that your policies at the margin helped growth was an admission that you were doing too little, or more likely that you were doing your analysis badly.

Let me explain. Suppose policymakers have two objectives: protecting the economy and saving jobs. (In reality, there were other objectives, like the negative liberty of individuals to make their own choices or the positive liberty of individuals to avoid being exposed to the virus—both of which I will ignore because I am making a conceptual argument not relitigating pandemic policy.) Given those two objectives, they should find and adopt every policy that advances both objectives, for the sake of argument I will say this includes mandatory masking and improved air circulation and filtration. But we would not be doing enough because we would want to go further and adopt policies that save lives at a reasonable cost. Again for the sake of argument, mandatory shutting of bars and restaurants in 2020 may have saved a lot of lives at an acceptable cost in terms of lost jobs and GDP so it made sense. But going further and shutting down outdoor construction sites, as happened in some places and countries, would possibly have saved a life or two but at an unacceptably large cost in terms of jobs and GDP.

I am not arguing the merits of my particular analysis of the pandemic response. I am not saying it is easy to get this right. I am also not saying that the only objectives are saving lives and saving GDP, other objectives like personal freedom to make ones own choices or the freedom to protected from the virus are important and contested objectives. But I am saying that if you are not hurting growth you are doing too little.

I am not saying it is easy to stand up and say, "adopt my policy, it will hurt economic growth." I have spent enough time in the political system to understand how difficult it is to talk about tradeoffs. But I lament that fact, I do not celebrate it. And I am worried that increasingly new political-economic ideologies are emerging that instead of lamenting it and pushing against it celebrate the end of tradeoffs. These are grounded in a desire to move past what is called "neoliberalism," a poorly defined term that appears to include everyone from James Tobin to Milton Friedman.

The Problems of Post-neoliberalism

In recent years there has been a tidal wave of criticisms of "neoliberalism" and an attempt to create a "post-neoliberal" approach to economic policymaking. There are a number of criticisms but many of the most important fall under a few headings:

First, is what I have been discussing as the "liberal vice": the belief that economics has overprioritized scarcity and budget constraints. Instead, there are numerous ways in which current policymaking is deeply inefficient, falling well within the production possibility frontier. Policymaking should focus on win-win opportunities to advance multiple goals simultaneously.

Second, is skepticism about unintended consequences, including the constraints posed by individual optimization.

Third is a belief that we should not center policymaking on correcting market failures or harnessing markets to achieve broader goals. It is skeptical that we can itemize specific market failures, like an externality, and correct it with a tax that leaves the market to function properly.

Finally, the post-neoliberal criticism is bothered by what it sees as the limits on change imposed by an over-reliance on technocracy, it is as much a call for a broader political project to bring about change as it is as new and different approach to economic policy.

Discontent with economics and the role of economists in policymaking is not new. The supply siders on the right, led by people like Arthur Laffer, articulated frustrations similar to these while advancing propositions like tax cuts pay for themselves that had little support in the academy or among the technocrats in government.

More recently, this discontent has led to the growth of new so-called schools of thought in economic policymaking. One of them is Modern Monetary Theory (MMT), which allows itself to be heard as deficits do not matter and there is no debt sustainability constraint. This eliminates the budget constraint so we do not need to ask whether the cost of a policy is worthwhile. And by assuming there is no crowd out, MMT avoids having to ask tough questions about whether expanded government investment is better than the private investment it displaces—a test that I believe some but not all government investment passes.

A second post-neoliberal approach to policymaking is the neo-Brandeisian approach to competition. I will discuss this in a bit more detail because it fits into the framework of the liberal vice.

Finally a third is a belief in industrial policy as a cure all for increasing economic growth, reducing inequality and serving other objectives—like addressing climate change or enhacing national security.

I will discuss the Neo-Brandesian approach and industrial policy in turn.

A Deeper Dive Into the Neo-Brandesian Approach

The dominant law and economics approach to antitrust is focused on assessing the balance between the pro-competitive benefits and anti-competitive harms that result from increased concentration. The goal is to protect competition not competitors, which is implemented by assessing the impact on consumers in terms of prices, variety, quality, or innovation.

The neo-Brandesians reject this approach. First, they have a deep skepticism for the tradeoffs implicit in this framework or the ability of economic technocrats and courts to assess it. Instead, they generally think that all good things go together—that reduced concentration will not just reduce prices for consumers it will also increase efficiency. As a result, the typical repertoire of SSNIP tests, HHIs, price-cost margins, and other mainstays of antitrust analysis should be discarded as technocratic barriers to the right outcome.

Second, the neo-Brandesians explicitly support multiple goals. The Assistant Attorney General for antitrust has talked about the inherent value of protecting small businesses and the administration has flirted with restoring enforcement of the Robinson-Patman Act to protect small grocers from the harm that low prices would do to their businesses.

Although it has not made it to actual policymakers, the intellectual proponents of the neo-Brandesian approach have talked about such lofty goals as protecting democracy—making arguments that, for example, airline mergers help businesses reduce the collective action impediments to more effectively lobbying the government to extract benefits for their industries. Other values that are also mentioned include protecting health, jobs, privacy, human rights, local media and diversity.

There is much to discuss in this approach but I want to limit myself to the aspect that relates to my talk today, whether all good things go together. Let’s take a closer look at whether competition policy should protect small businesses.

If protecting small businesses is always good for consumers then it is superfluous as an objective. It is not really a substantive argument, just a propaganda, another argument for something you already believed for other reasons.

But neo-Brandesians are criticizing the consumer welfare standard and make arguments like small businesses are vital for democracy and enrich our society. Presumably that means their well-being should also be in the objective function along with the well-being of consumers. Which also means that, in some cases, they are effectively advocating that we should make consumers worse off to achieve the goal of supporting small businesses. That is not obviously wrong, at the beginning of this talk we established that much of this room would be willing to pay an economic price to prevent Trump from becoming President again. But it does deserve to be made explicit and quantified so that people can make the appropriate choices. Maybe they do not want to give up on cheap supermarket groceries in order to support the continued existence of smaller grocery stores.

The same logic applies to other goals the neo-Brandesians have argued should motivate antitrust, like protections for democracy. (I should say I personally do not buy the premise the corporate concentration has much to do with political power, wealth might be that is not the same as concentration—just witness how much power community banks, car dealers, hedge funds and private equity have, all of which are relatively competitive industries.) Suppose that breaking up a digital giant resulted in worse products for consumers but reduced corporate concentration and thus helped democracy, would it be a good idea? You would need to quantify the impact on democracy the cost for consumers in order to have that debate. But if you think all good things go together you will end not even entering into that conversation.

A Deeper Dive into Industrial Policy

I wanted to offer a second example which is industrial policy, including subsidies, tariffs, regulations and other ways in which the government tries to shape economic activity. Political proponents of it often argue that it will increase economic growth and support middle class jobs while achieving other goals, like addressing climate change or increasing national security. As I said, I have a lot of tolerance for political pronouncements but those doing the analysis need to be much more careful and hard headed.

These policies do not just affect the factories or workers supported by them but have impacts throughout the economy. In a full employment economy industrial subsidies that are not paid for could lead to higher mortgage rates, so the workers who get the jobs benefit but tens of millions of others pay the cost. Or even if paid for, they could lead to higher construction costs which would hurt factory building by industries that are not subsidized. Industrial subsidies go to companies and many of the beneficiaries of them could be shareholders or other owners of capital, not the inequality reduction they are supposed to be supporting.

Tariffs could lead to exchange rate appreciation, meaning they help some businesses by shielding them from competition but make it harder for other businesses to export—and that is before even considering the tariffs the might happen in retaliation. Tariffs may be populist in that they do really help certain concentrated interests who correctly understand the consequences of the policy and are supported more broadly by a populace that does not understand the consequences which are small enough for them individual that it is rational not to make that effort even if the total net damage to society is very large.

As an aside, people talk about this exactly right when it comes to sanctions on Russia. I have never heard anyone argue that they are a good way to protect America's industrial base or support our oil industry or help middle class Americans. In fact, it is generally accepted that sanctions on Russia are mildly costly for the U.S. economy—a cost that policymakers have tried to ameliorate through measures like the oil price cap. This cost, however, is viewed as justified—and I agree—because it is in service of another foreign policy goal, reversing and deterring future unprovoked aggression. In contrast, it is much less common to hear trade restrictions on China discussed as imposing a cost on Americans economically in service of another non-economic goal like national security—even though this is probably the better way to look at it.

This is not to say do not do industrial policy or tariffs. The United States, for example, should probably have the capacity to produce drones at substantial scale due to our national security. But if we support drone-building factories the argument for that is not that it helps the middle class. In fact it is the opposite, we are willing to impose an extra cost on the middle class in order to support our national security—just like we do with the defense budget writ large.

The problem with ignoring these tradeoffs is that you end up without any limiting principles for where industrial policy should stop. You also end up sometimes hurting your other objectives, for example less emissions reductions as a result of local content requirements. And you can miss out on some of the most powerful and even more progressive tools to achieve goals, like the carbon tax I will discuss briefly in a moment.

A Better Alternative

What is a better alternative to this way of thinking? Here I will just talk my book as a former economic adviser in government and teacher of an introductory economics course you might not be surprised to know that I think it is more economics. And, possibly a much taller order, getting more comfortable with admitting and talking about tradeoffs.

Government does a lot of this already. For fiscal policies, although politicians rhetorically like to describe them as paying for themselves, most of them ultimately defer to the Congressional Budget Office (CBO)'s cost estimates—implicitly trading off the fiscal cost against whatever benefit they are trying to achieve. For regulatory policies, cost-benefit analysis is a staple of the regulatory process, even if its inclusion of gross costs is often at odds with the political rhetoric which is about the win-win only having gains. For competition policy, economic analysis that looks at the impacts on consumer welfare—in the short run and also in the longer run.

But the analysis done in the government and by outside groups is often not do enough to help inform policymakers. CBO quantifies fiscal costs but not the magnitude of emissions reductions and consequences for climate. Government agencies calculate total costs and benefits without considering the effects of these policies on marginal utility which will differ because of their distributional impact (although I should note, that in principle President Biden's recent Executive Order includes these considerations). Dynamic analysis of tax policies is increasingly common but rarely incorporate the appropriate welfare analysis about the distribution of the tax cut and the welfare impacts of the changes it induces for leisure and consumption.

The policy analytic community needs to do a better job of drawing on the economics literature to incorporate the multiple considerations that go into any policy. This is not easy to do analytically. It also gets morally perilous. Economic growth is a seemingly objective measure but social welfare depends on your values. So it is important that the analysis be framed in a way that is either agnostic about values or is an if-then statement, like providing menus of costs for reducing child poverty or carbon emissions—without any explicit statement of the underlying value of either of those goals.

A lot more will be needed until the analysis exists and the political system gets more comfortable using it. But I do not think this is an impossible task. Sixty years ago revenue estimates, distribution tables and cost-benefit analysis played no role in the policy process. Now they are all commonplace. Given the broad set of goals policymakers have we need to be building on all of those and doing more.

Technocratic Economics Gives Voice to the Voiceless

I suspect some will agree with many of the particulars but worry that this all adds up to a technocratic obscurantism that will get in the way of action. Too much worrying about tradeoffs and demanding analysis will slow things down. We need a political project oriented around change and not weighted down by the neoliberal, technocratic economics that got in the way of progress over the last half century.

You are probably unsurprised to hear that I disagree.

I strongly believe the world is a better place when you get the analysis right, and sometimes the differences are first order. The fiscal stimulus in 2009 was too small not because of economic analysis but despite it—it was impossible to persuade the political system to accept the large numbers that the economists came up with through their multiplier models. Conversely, when Donald Trump threw out the idea of $2,000 stimulus checks—and the Democrats quickly adopted it as a way to troll Senate Republicans—this was not based on any form of macroeconomic analysis. The harm from doing too little in 2009 was probably greater than from doing too much in 2021 but in both cases it was unnecessary. In many, many other cases the issue was that that quants in the room were not listened to—not that they were.

Perhaps more important, by considering tradeoffs economic analysis can voice to the people that are often voiceless. Many policies are supported by their direct beneficiaries. They understand the benefits and actively lobby for them. The tradeoffs and unintended consequences are often more diffuse and unclear and as a result the people affected by them are underrepresented in the political process.

Cancelling student debt is an excellent illustration of this point. This was a policy that would have directly benefited nearly 30 million Americans. If this was the only effect of the policy then it deserved universal support. Even if those 30 million Americans skewed towards higher incomes by virtue of being college graduates, most of them surely would benefit from the help they received. But it is not the only effect. In a full employment economy, to the degree the policy had increased consumption by the direct beneficiaries it would have reduced it for others, with a combination of higher prices and higher interest rates achieving this equilibrium. Suppose the policy added 0.2 percent to inflation, a plausible estimate, then it would have been like a lower-income family chipping in $50 in reduced consumption to offset the increased consumption by a beneficiary of student debt relief. In addition, the eventual financing of the plan would have required future spending cuts or tax increases, who would eventually pay for those? It is possible that going through this analysis you would end up still supporting student debt relief. It is possible that, like me, you would oppose it. But whatever answer you came up with would be a more democratic reflection of the full set of Americans affected by the policy than just listening to the beneficiaries.

Similarly, the argument for industrial policies, including tariffs, should not be about the benefits for the industries and workers it directly affects. These are the ones that come in and lobby but you need to also understand what happens to other businesses either because spending drives up mortgage rates or because tariffs lead to currency appreciation that hurts other exporters or many of the other ways in which these policies have diffuse, but collectively large, impacts on the many others in the economy.

This analysis does not just lead you to do nothing or to do small ball. There is a large literature on optimal tax, much of it published in top scientific journals. It does not give a definitive answer—one prominent proposal supported a 19 percent flat tax rate while another provided an economic rationale for a top tax rate above 90 percent. Notably both of these ideas are considerably more radical than anything under consideration by the political system. And, as is often the case, economics differences on elasticities, other considerations like externalities and normative values.

In other areas economists do have much broader agreement. For example, most economists support radical solutions like a meaningful carbon tax with rebates that—if they could ever be passed—would do much more than the Inflation Reduction Act which was is expected to result in as much emissions reductions as would come from a very mild carbon tax of less than $10 a ton. The reason is something I have not discussed enough today but will leave for another time—the power of markets and decentralized decision making by millions of businesses and hundreds of millions of consumers when they are given the right incentives. That really is something economists are generally guilty of as charged—maybe even "neoliberal"—but it is still a radical idea that good can come out of choices that were not necessarily themselves well intentioned—a radical idea that goes all the way back to Adam Smith.

In many cases the failure of the so-called post-neoliberals and populists to take quantification seriously leads them to be less ambitious not more in their solutions. With tax and transfer policies you can relatively easily quantify the direct impact and sometimes the indirect impact too. A carbon tax can be done at scale and forces you to take distributional considerations seriously. But if you are remaking the economy through industrial policy or new place-based policies it is much easier to get away with transformational claims that are not backed by ambitious action. For all the talk of greed and inflation the policies associated with that perspective did not take even 0.1 percentage point off the inflation rate and all the discussion of reviving manufacturing over the last eight years has coincided with a steady shrinking of the already small employment in the sector and associated levelling off of output.

Conclusion

Modern economics does not start with the conclusion but with a set of ways of thinking and learning and changing ones mind. That includes theoretical tools for thinking about how people do and society ought to handle tradeoffs. And empirical techniques for assessing how they play out in the real world. Both of these do support some broad notions, like the tremendous benefits of markets as a way of organizing economic activity and achieving a range of goals. But they do not say that is only free markets or give clear and unambiguous answers about the role of government in these markets.

My points today should not rise and fall on any particular policy statement I made. My broader argument is that we should not be afraid of tradeoffs. We should avoid the liberal vice of getting the sign wrong and thinking all good things go together or the conservative vice of getting the magnitude wrong and stopping us from pursing beneficial actions. Considering and talking about tradeoffs can be hard but that is no excuse for policy analysts celebrating the alternative approach of not doing so. The analytic community instead needs to do a better job of showing how the goals that so many people rightfully care about will be better advanced by the types of analysis that we all do.