

PRAISE FOR
GOOD ECONOMICS FOR HARD TIMES

“In *Good Economics for Hard Times*, Banerjee and Duflo, two of the world’s great economists, parse through what economists have to say about today’s most difficult challenges—immigration, job losses from automation and trade, inequality, tribalism and prejudice, and climate change. The writing is witty and irreverent, always informative but never dull. Banerjee and Duflo are the teachers you always wished for but never had, and this book is an essential guide for the great policy debates of our times.”

—**Raghuram Rajan**, Katherine Dusak Miller Distinguished Service Professor of Finance, University of Chicago Booth School of Business

“Banerjee and Duflo move beyond the simplistic forecasts that abound in the Twittersphere and in the process reframe the role of economics. Their dogged optimism about the potential of economics research to deliver makes for an informative and uplifting read.”

—**Pinelopi Goldberg**, Elihu Professor of Economics, Yale University, and chief economist of the World Bank Group

“Not all economists wear ties and think like bankers. In their wonderfully refreshing book, Banerjee and Duflo delve into impressive areas of new research questioning conventional views about issues ranging from trade to top income taxation and mobility, and offer their own powerful vision of how we can grapple with them. A must-read.”

—**Thomas Piketty**, professor, Paris School of Economics, and author of *Capital in the Twenty-First Century*

“A magnificent achievement, and the perfect book for our time. Banerjee and Duflo brilliantly illuminate the largest issues of the day, including immigration, trade, climate change, and inequality. If you read one policy book this year—heck, this decade—read this one.”

—**Cass R. Sunstein**, Robert Walmsley University Professor, Harvard University, and author of *How Change Happens*

“Banerjee and Duflo have shown brilliantly how the best recent research in economics can be used to tackle the most pressing social issues: unequal economic growth, climate change, lack of trust in public action. Their book is an essential wake-up call for intelligent and immediate action!”

—**Emmanuel Saez**, professor of economics at UC Berkeley

“One of the things that makes economics interesting and difficult is the need to balance the neat generalities of theory against the enormous variety of deviations from standard assumptions: lags, rigidities, simple inattention, [and] society’s irrepressible tendency to alter what are sometimes thought of as bedrock characteristics of economic behavior. Banerjee and Duflo are masters of this terrain. They have digested hundreds of lab experiments, field experiments, statistical studies, and common observations to find regularities and irregularities that shape important patterns of economic behavior and need to be taken into account when we think about central issues of policy analysis. They do this with simple logic and plain English. Their book is as stimulating as it gets.”

—**Robert Solow**, Nobel Prize–winner and emeritus professor of economics, Massachusetts Institute of Technology

“In these tumultuous times when many bad policies and ideas are bandied around in the name of economics, common sense—and good economics—is even more sorely needed than usual. This wide-ranging and engaging book by two leading economists puts the record straight and shows that we have much to learn from sensible economic ideas, and not just about immigration, trade, automation, and growth, but also about the environment and political discourse. A must-read.”

—**Daron Acemoglu**, Elizabeth and James Killian Professor of Economics, MIT, and coauthor of *Why Nations Fail*

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To our children, Noemie and Milan,
in the hope that they grow up
to a more just and humane world,

and for Sasha, who didn't get a chance.

CONTENTS

Preface	ix
1 MEGA: Make Economics Great Again	i
2 From the Mouth of the Shark	10
3 The Pains from Trade	51
4 Likes, Wants, and Needs	98
5 The End of Growth?	146
6 In Hot Water	208
7 Player Piano	227
8 Legit.gov	263
9 Cash and Care	277
Conclusion: Good and Bad Economics	323
Notes	327
Acknowledgments	385
Index	387

PREFACE

Ten years ago we wrote a book about the work we do. To our surprise, it found an audience. We were flattered, but it was clear to us that we were done. Economists do not really write books, least of all books human beings can read. We did it and somehow got away with it; it was time to go back to what we normally do, which is to write and publish research papers.

Which is what we were doing while the dawn-light of the early Obama years gave way to the psychedelic madness of Brexit, the Yellow Vests, and the Wall—and strutting dictators (or their elected equivalents) replaced the confused optimism of the Arab Spring. Inequality is exploding, environmental catastrophes and global policy disasters loom, but we are left with little more than platitudes to confront them with.

We wrote this book to hold on to hope. To tell ourselves a story of what went wrong and why, but also as a reminder of all that has gone right. A book as much about the problems as about how our world can be put back together, as long as we are honest with the diagnosis. A book about where economic policy has failed, where ideology has blinded us, where we have missed the obvious, but also a book about where and why good economics is useful, especially in today's world.

The fact that such a book needs to be written does not mean we are the right people to write it. Many of the issues plaguing the world right now are particularly salient in the rich North, whereas we have spent our lives studying poor people in poor countries. It was obvious that we would have to immerse ourselves in many new literatures, and there was always a chance we would miss something. It took us a while to convince ourselves it was even worth trying.

We eventually decided to take the plunge, partly because we got tired of watching at a distance while the public conversation about

core economic issues—immigration, trade, growth, inequality, or the environment—goes more and more off-kilter. But also because, as we thought about it, we realized the problems facing the rich countries in the world were actually often eerily familiar to those we are used to studying in the developing world—people left behind by development, ballooning inequality, lack of faith in government, fractured societies and polity, and so on. We learned a lot in the process, and it did give us faith in what we as economists have learned best to do, which is to be hard headed about the facts, skeptical of slick answers and magic bullets, modest and honest about what we know and understand, and perhaps most importantly, willing to try ideas and solutions and be wrong, as long as it takes us toward the ultimate goal of building a more humane world.

CHAPTER 1

MEGA: MAKE ECONOMICS GREAT AGAIN

A woman hears from her doctor that she has only half a year to live. The doctor advises her to marry an economist and move to South Dakota.

WOMAN: “Will this cure my illness?”

DOCTOR: “No, but the half year will seem pretty long.”

WE LIVE IN AN AGE of growing polarization. From Hungary to India, from the Philippines to the United States, from the United Kingdom to Brazil, from Indonesia to Italy, the public conversation between the left and the right has turned more and more into a high-decibel slanging match, where harsh words, used wantonly, leave very little scope for backtracking. In the United States, where we live and work, split-ticket voting is at its lowest on record.¹ Eighty-one percent of those who identify with one party have a negative opinion of the other party.² Sixty-one percent of Democrats say they view Republicans as racists, sexists, or bigots. Fifty-four percent of Republicans call Democrats spiteful. A third of all Americans would be disappointed if a close family member married someone from the other side.³

In France and India, the two other countries where we spend a lot of time, the rise of the political right is discussed, in the liberal, “enlightened” elite world we inhabit, in increasingly millenarian terms. There is a clear feeling that civilization as we know it, based on democracy and debate, is under threat.

As social scientists, our job is to offer facts and interpretations of facts we hope will help mediate these divides, help each side understand what the other is saying, and thereby arrive at some reasoned disagreement, if not a consensus. Democracy can live with dissent, as long as there is respect on both sides. But respect demands some understanding.

What makes the current situation particularly worrying is that the space for such conversations seems to be shrinking. There seems to be a “tribalization” of views, not just about politics, but also about what the main social problems are and what to do about them. A large-scale survey found Americans’ views on a broad spectrum of issues come together like bunches of grapes.⁴ People who share some core beliefs, say about gender roles or whether hard work always leads to success, seem to have the same opinions on a range of issues, from immigration to trade, from inequality to taxes, to the role of the government. These core beliefs are better predictors of their policy views than their income, their demographic groups, or where they live.

These issues are in some ways front and center in the political discourse, and not just in the United States. Immigration, trade, taxes, and the role of government are just as contested in Europe, India, South Africa, or Vietnam. But views on these issues are all too often based entirely on the affirmation of specific personal values (“I am for immigration because I am a generous person,” “I am against immigration because migrants threaten our identity as a nation”). And when they are bolstered by anything, it is by made-up numbers and very simplistic readings of the facts. Nobody really thinks very hard about the issues themselves.

This is really quite disastrous, because we seem to have fallen on hard times. The go-go years of global growth, fed by trade expansion and China’s amazing economic success, may be over, what with China’s growth slowing and trade wars igniting everywhere. Countries that prospered from that rising tide—in Asia, Africa, and Latin America—are beginning to wonder what is next for them. Of course, in most countries in the affluent West, slow growth is nothing new at this point, but what makes it particularly worrying is the rapid fraying of the social contract that we see across these countries. We seem to be back in the Dickensian world of *Hard Times*, with the haves facing

off against the increasingly alienated have-nots, with no resolution in sight.⁵

Questions of economics and economic policy are central to the present crisis. Is there something that can be done to boost growth? Should that even be a priority for the affluent West? And what else? What about exploding inequality everywhere? Is international trade the problem or the solution? What is its effect on inequality? What is the future on trade—can countries with cheaper labor costs lure global manufacturing away from China? And what about migration? Is there really too much low-skilled migration? What about new technologies? Should we, for example, worry about the rise of artificial intelligence (AI) or celebrate it? And, perhaps most urgently, how can society help all those people the markets have left behind?

The answers to these problems take more than a tweet. So there is an urge to just avoid them. And partly as a result, nations are doing very little to solve the most pressing challenges of our time; they continue to feed the anger and the distrust that polarize us, which makes us even more incapable of talking, thinking together, doing something about them. It often feels like a vicious cycle.

Economists have a lot to say about these big issues. They study immigration to see what it does to wages, taxes to determine if they discourage enterprise, redistribution to figure out whether it encourages sloth. They think about what happens when nations trade, and have useful predictions about who the winners and losers are likely to be. They have worked hard to understand why some countries grow and others don't and what, if anything, governments can do to help. They gather data on what makes people generous or wary, what makes a man leave his home for a strange place, how social media plays on our prejudices.

What the most recent research has to say, it turns out, is often surprising, especially to those used to the pat answers coming out of TV "economists" and high school textbooks. It can shed new light on those debates.

Unfortunately, very few people trust economists enough to listen carefully to what they have to say. Right before the Brexit vote, our colleagues in the UK desperately tried to warn the public that Brexit would be costly, but they felt they were not getting through. They

were right. No one was paying much attention. Early in 2017, YouGov conducted a poll in the UK in which they asked: “Of the following, whose opinions do you trust the most when they talk about their field of expertise?” Nurses came first. Eighty-four percent of people polled trusted them. Politicians came last, at 5 percent (though local members of Parliament were a bit more trusted, at 20 percent). Economists were just above politicians at 25 percent. Trust in weather forecasters was twice as high.⁶ In the fall of 2018, we asked the same question (as well as several others about views on economic issues, which we make use of at various points in the book) to ten thousand people in the United States.⁷ There again, just 25 percent of people trusted economists about their own field of expertise. Only politicians ranked lower.

This trust deficit is mirrored by the fact that the professional consensus of economists (when it exists) is often systematically different from the views of ordinary citizens. The Booth School of Business at the University of Chicago regularly asks a group of about forty academic economists, all recognized leaders in the profession, their views on core economic topics. We will often refer to these in the book as the IGM Booth panel answers. We selected ten questions asked of the IGM Booth respondents and posed the same questions to our survey respondents. On most of these issues, economists and our respondents were completely at odds with each other. For example, every single respondent in the IGM Booth panel disagreed with the proposition that “imposing new US tariffs on steel and aluminum will improve Americans’ well-being.”⁸ Just over one-third of our respondents shared this view.

In general, our respondents tended to be more pessimistic than the economists: 40 percent of economists agreed with the proposition that “the influx of refugees into Germany beginning in the summer of 2015 would bring economic benefits to Germany over the succeeding decade,” and most of the rest were uncertain or did not give an opinion (only one disagreed).⁹ In contrast, only a quarter of our respondents agreed, and 35 percent disagreed. Our respondents were also more likely to think the rise of robots and AI would lead to widespread unemployment, and much less likely to think they would create enough extra wealth to compensate those who lost out.¹⁰

This is not because economists are always more in favor of *laissez-faire* outcomes than the rest of the world. A prior study compared how

economists and a thousand regular Americans answered the same twenty questions.¹¹ They found economists were (much) more in favor of raising federal taxes (97.4 percent of economists were in favor, compared to 66 percent of regular Americans). They also had much more faith in the policies pursued by the government after the 2008 crisis (bank bailouts, the stimulus, etc.) than the public at large. On the other hand, 67 percent of regular Americans but only 39 percent of professional economists agreed with the idea that CEOs of large companies were overpaid. The key finding is that, overall, the average academic economist thinks very differently from the average American. Across all twenty questions, there is a gaping chasm of 35 percentage points between how many economists agree with a particular statement and how many average Americans do.

Moreover, informing respondents about what prominent economists think of those issues does nothing to change their point of view. For three questions where the experts' view was markedly different from that of the public, researchers varied the way they asked the question. For some respondents, they first stated, "Nearly all experts agree that . . ." before posing the question; for others they just asked the question. It made no difference in the answers they got. For example, on the question of whether the North American Free Trade Agreement increased the average person's well-being (to which 95 percent of economists answered yes), 51 percent of respondents answered yes if they were provided with the economists' view, and 46 percent when they were not. A small difference at best. From this, it seems a large part of the general public has entirely stopped listening to economists about economics.

We don't for a moment believe that when economists and the public have different views, economists are always right. We, the economists, are often too wrapped up in our models and our methods and sometimes forget where science ends and ideology begins. We answer policy questions based on assumptions that have become second nature to us because they are the building blocks of our models, but it does not mean they are always correct. But we also have useful expertise no one else has. The (modest) goal of this book is to share some of this expertise and reopen a dialogue about the most urgent and divisive topics of our times.

For that, we need to understand what undermines trust in economists. A part of the answer is that there is plenty of bad economics around. Those who represent the “economists” in the public discourse are not usually the same people who are part of the IGM Booth panel. The self-proclaimed economists on TV and in the press—chief economist of Bank X or Firm Y—are, with important exceptions, primarily spokespersons for their firms’ economic interests who often feel free to ignore the weight of the evidence. Moreover, they have a relatively predictable slant toward market optimism at all costs, which is what the public associates with economists in general.

Unfortunately, in terms of how they look (suit and tie) or the way they sound (lots of jargon), the talking heads are hard to tell apart from academic economists. The most important difference is perhaps in their willingness to pronounce and predict, which unfortunately makes them all the more authoritative. But they actually do a pretty poor job of predicting, in part because predictions are often well-nigh impossible, which is why most academic economists stay away from futurology. One of the jobs of the International Monetary Fund (IMF) is to forecast the rate of growth of the world economy in the near future. Without a whole lot of success, one might add, despite its team of many very well-trained economists. The *Economist* magazine once computed just how far the IMF’s forecasts were off on average over the period 2000–2014.¹² For two years from the time of prediction (say, the growth rate in 2014 predicted in 2012), the average forecast error was 2.8 percentage points. That’s somewhat better than if they had chosen a random number between –2 percent and 10 percent every year, but about as bad as just assuming a constant growth rate of 4 percent. We suspect these kinds of things contribute substantially to the general skepticism of economics.

Another big factor that contributes to the trust gap is that academic economists hardly ever take the time to explain the often complex reasoning behind their more nuanced conclusions. How did they parse through the many possible alternative interpretations of the evidence? What were the dots, often from different domains, they had to connect to reach the most plausible answer? How plausible is it? Is it worth acting upon, or should we wait and see? Today’s media culture does not naturally allow a space for subtle or long-winded explanations.

Both of us have had to wrangle with TV anchors to tell our full story (often to have it edited out of what gets shown), so we recognize why academic economists are often unwilling to take on the responsibility of speaking out. It takes a lot of effort to be heard properly, and there is always the risk of sounding half-baked or having one's careful words manipulated to mean something quite different.

There are of course those who do speak out, but they tend to be, with important exceptions, those with the strongest opinions and the least patience for engaging with the best work in modern economics. Some, too beholden to some orthodoxy to pay attention to any fact that does not square with it, repeat old ideas like a mantra, even though they have long been disproved. Others are there to pour scorn on mainstream economics, which it may sometimes deserve; but that often means they are unlikely to speak for today's best economic research.

Our sense is that the best economics is frequently the least strident. The world is a sufficiently complicated and uncertain place that the most valuable thing economists have to share is often not their conclusion, but the path they took to reach it—the facts they knew, the way they interpreted those facts, the deductive steps they took, the remaining sources of their uncertainty. This is related to the fact that economists are not scientists in the sense physicists are, and they often have very little absolute certainty to share. Anyone who has watched the comic TV series *The Big Bang Theory* knows that physicists look down on engineers. Physicists think deep thoughts, while engineers muck around with materials and try to give shape to those thoughts; or at least that's how the series presents it. If there were ever a TV series that made fun of economists, we suspect we would be several rungs below engineers, or at least the kind of engineers who build rockets. Unlike engineers (or at least those on *The Big Bang Theory*), we cannot rely on some physicist to tell us exactly what it would take for a rocket to escape the earth's gravitational pull. Economists are more like plumbers; we solve problems with a combination of intuition grounded in science, some guesswork aided by experience, and a bunch of pure trial and error.

This means economists often get things wrong. We will no doubt do so many times in this book. Not just about the growth rate, which is mostly a hopeless exercise, but also about somewhat more limited

questions, like how much carbon taxes will help with climate change, how CEOs' pay might be affected if taxes were to be raised a lot, or what universal basic income would do to the structure of employment. But economists are not the only ones who make mistakes. Everyone gets things wrong. What is dangerous is not making mistakes, but to be so enamored of one's point of view that one does not let facts get in the way. To make progress, we have to constantly go back to the facts, acknowledge our errors, and move on.

Besides, there is plenty of good economics around. Good economics starts with troubling facts, makes some guesses based on what we already know about human behavior and theories elsewhere shown to work, uses data to test those guesses, refines (or radically alters) its line of attack based on the new set of facts, and eventually, with some luck, gets to a solution. In this, our work is also a lot like medical research. Siddhartha Mukherjee's wonderful book on the fight against cancer, *The Emperor of All Maladies*, tells a story of combining inspired guesswork with careful testing, and many rounds of refinement, before a new drug gets to the market.¹³ A big part of the economist's work is very much like that. As in medicine, we are never sure we have reached the truth, just that we have enough faith in an answer to act on it, knowing we may have to change our minds later. Also like in medicine, our work does not stop once the basic science is done and the core idea is established; the process of rolling out the idea in the real world then begins.

At one level, one could think of this book as a report from the trenches where that research happens: what does the best economics of today tell us about the fundamental issues our societies are grappling with? We describe how today's best economists think about the world; not just their conclusions but also how they got there, all the while trying to separate facts and pipe dreams, brave assumptions and solid results, what we hope for and what we know.

It is important that in this project we be guided by an expansive notion of what human beings want and what constitutes the good life. Economists have a tendency to adopt a notion of well-being that is often too narrow, some version of income or material consumption. And yet all of us need much more than that to have a fulfilling life: the respect of the community, the comforts of family and friends, dignity,

lightness, pleasure. The focus on income alone is not just a convenient shortcut. It is a distorting lens that often has led the smartest economists down the wrong path, policy makers to the wrong decisions, and all too many of us to the wrong obsessions. It is what persuades so many of us that the whole world is waiting at the door to take our well-paying jobs. It is what has led to a single-minded focus on restoring the Western nations to some glorious past of fast economic growth. It is what makes us simultaneously deeply suspicious of those who don't have money and terrified to find ourselves in their shoes. It is also what makes the trade-off between the growth of the economy and the survival of the planet seem so stark.

A better conversation must start by acknowledging the deep human desire for dignity and human contact, and to treat it not as a distraction, but as a better way to understand each other, and to set ourselves free from what appear to be intractable oppositions. Restoring human dignity to its central place, we argue in this book, sets off a profound rethinking of economic priorities and the ways in which societies care for their members, particularly when they are in need.

That said, on any single issue we will cover in the book, or perhaps all of them, you may well come to a different conclusion than we do. We hope to persuade you not reflexively to agree with us, but to adopt a little bit of our methods and share some part of our hopes and fears, and perhaps by the end, we will really be talking to each other.