REVIEW ESSAY

The Quants in the Room

How Much Power Do Economists Really Have?

By Jason Furman July/August 2022

In This Review

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In 1962, Kenneth Arrow, one of the greatest economists of the twentieth century, joined the U.S. Council of Economic Advisers, which had been created a decade and a half earlier to provide impartial economic analysis to the president. John F. Kennedy had recently won the White House, and the Democratic Party was engaged in a debate about whether and how to expand access to health insurance. It was a discussion in which Arrow was well positioned to participate. Arrow was an expert on market behavior and failures, and the next year, he would publish a landmark paper in the *American Economic Review* that established the discipline of health economics. It argued that the health-care market was riddled with bad information and bargaining power asymmetries that made fair pricing extraordinarily difficult: a foundational idea that has since shaped how health-care experts think about their field.

Three years after Arrow entered the White House, Congress established Medicare and Medicaid: government-run health insurance programs for people older than 65 and for the very poor, respectively. These represented the largest changes in health policy in U.S. history, and given Arrow's position and work, it would be natural to think that he had a part in their creation. But when I asked him in 2015 what role he played in the establishment of these programs, his answer surprised me: essentially none. Arrow, who would eventually win a Nobel Prize for his contributions to economics, hadn't been consulted on Medicare and Medicaid in any way—when he was in government or out of it.

In retrospect, his absence from these efforts is astonishing. Today, it is inconceivable that such a monumental change, or even a minor change, in almost any federal policy could happen without the involvement of economists. If Congress set out to further expand health care now, for example, the Brookings Institution, Harvard University, and a welter of other think tanks and universities would churn out policy papers and ideas. The Urban Institute and the RAND Corporation would scrutinize any government proposal. The corridors of the White House and the Congressional Budget Office would be filled with economists, and government staffers in both the executive and legislative branches would pore over their analyses.

But as the University of Michigan sociologist Elizabeth Popp Berman shows in *Thinking Like an Economist*, for much of modern U.S. history, economists held little sway over policymaking. It wasn't until the 1960s that the discipline began playing a serious role in regulation and rule-making. From then through the mid-1980s, government agencies established economic and policy offices to conduct cost-benefit analyses of proposals. To support these offices, educational leaders and academics developed a network of public policy schools and master's degree programs, as well as new think tanks and policy evaluation companies. Judges started using economic analysis in their opinions. Eventually, the discipline was not just part of policymaking; it was central to it.

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The historical account in *Thinking Like an Economist*, which makes up the bulk of the book, is an original, insightful, and persuasive story. Avoiding the well-known macroeconomic debates between the Keynesians (who emphasized the importance of government spending) and the monetarists (who focused on controlling the money supply), Berman provides a fresh perspective emphasizing a wide variety of microeconomic topics, including antitrust law, antipoverty policy, health care, and the environment. She also shifts the focus away from the role of the free-market right at places such as the University of Chicago. Instead, she argues that the increasing political power of economics was driven by the center-left. According to Berman, proponents of a bigger, more active government believed that economic analysis could help ensure that an expanded state would more efficiently achieve their goals, from reducing poverty to increasing access to transportation to keeping markets competitive.

It is to Berman's credit as a social scientist that she separates her own value judgments from her historical analysis, and a reader who skips the first and last chapters of her book would be mostly unaware that Berman disapproves of the developments she chronicles. Yet these chapters make clear that she deeply dislikes the rising power of economics, which she asserts has elevated efficiency above social and environmental equity and narrowed the ambitions of policymakers, curtailing the progress they could otherwise have made on single-payer health care, college-debt forgiveness, and other policies the progressive left favors. Berman argues that "Democrats' apparent lack of ambition" under Presidents Bill Clinton and Barack Obama was at least partly due to "the rise of a distinctive way of thinking about policy"—what she calls "the economic style of reasoning"—now prevalent in Washington.

In an era when free-market orthodoxy is under fierce attack, that charge is potent. Ultimately, however, Berman's case against economics is longer on assertion than proof. She underestimates the degree to which economic thought evolves as a result of genuine improvements in understanding, instead assuming that it is simply a projection of power and interest groups. She argues for focusing on rights, not consequences, yet she ignores the multitude of rights-based approaches that would go against her values, such as the libertarian view that high earners have the right to low taxes. Finally, she believes that economists and their style of reasoning are more influential than they actually are. I should know: while serving as chair of the Council of Economic Advisers, I could only dream of having the power she ascribes to people like me.

POWER OR PRESTIGE

According to Berman, economics first began its march to prominence during World War II, when governments relied on a field called "operations research" to figure out the best way to accomplish specific objectives, such as which array of planes to use for bombing missions. Operations research, the act of using quantitative methods to improve decision-making, has always been intertwined with economics, and its analytic success during the war prompted the U.S. Air Force to continue its funding even after the Allies won. To that end, in 1948, it established the RAND Corporation—one of the United States' first major think tanks.

RAND developed the Planning-Programming-Budgeting System, which, according to Berman, began "specifying the broad goals of an agency or office; identifying the various programs that might be used to achieve those goals; quantifying, to the extent possible, the cost-effectiveness of those alternative programs; and then using that information as a guide to budgeting." At first, this system was largely used by the armed forces. But in 1965, President Lyndon Johnson extended the PPBS to the entire executive branch, advancing the "economic style of reasoning" into domestic policy. Soon, agencies throughout the federal government began setting up offices to undertake this economic analysis, often headed by economists, such as Alice Rivlin and Alain Enthoven, who applied it to a range of budget-related domains. The offices were staffed with people with policy training. As the federal government began collecting more data on itself and on U.S. society, these offices and their employees could conduct increasingly sophisticated calculations. The growing demand for all this work was met by universities across the country, which established policy schools and launched new degrees involving economics.

Eventually, economists' work expanded from government budgets into the regulatory sphere, where they moved from cost-effectiveness analysis (which searches for the cheapest way to achieve a goal) to cost-benefit analysis (which asks whether the goal is worth pursuing in the first place). They began shaping major policy decisions. Economists persuaded President Jimmy Carter to deregulate the airline industry in 1978 and the trucking industry in 1980 by showing that, according to cost-benefit analysis, open airline and trucking markets would more efficiently and effectively transport people and goods. By the time President George H. W. Bush left office, cost-benefit analysis was an essential part of all regulatory policy.

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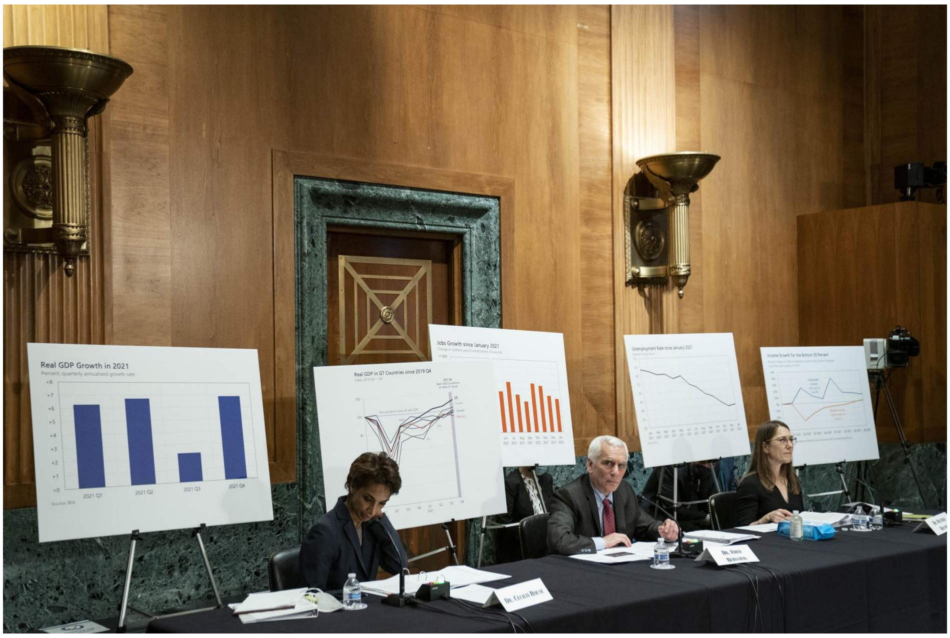
ideas than they deserve.

During the same period, through economic research, academics and lawyers began to shift away from the presumption that big companies were necessarily bad and to study the practical tradeoffs that mergers and corporate conduct have on consumers. In studies, economists showed that consolidation was far from uniformly negative, and their findings became increasingly influential at the Justice Department, the Federal Trade Commission, and, ultimately, in courts—greatly reducing the ambition of antitrust enforcement.

Today, economists have an office in the White House complex where they analyze how the economy will evolve in response to policy changes and who will win and lose as a result. They play similarly critical roles in most government agencies. They are deeply embedded in the budget process, in the regulatory process, and at enforcement agencies such as the FTC. Berman laments this development. "One might ask whether Medicare would have ever been created had the CBO [Congressional Budget Office] existed in 1965," she writes.

But her account is more flattering to the power of economists and their ideas than they deserve. Economics certainly has much more prestige in policymaking than does history, psychology, or other disciplines—there is no Council of Sociological Advisers—but very often, economics is still something policymakers use to find support for their existing ideas rather than to illuminate and better understand issues and debates. Indeed, officials frequently use economic analysis simply to rationalize decisions that they have already made. During a White House meeting, one person with a very important policy job applying the types of cost-benefit analysis Berman critiques leaned over to me and, referring to the president's deputy communications director, whispered, "Is he by far the most important person in this room? Or just narrowly the most important?"

Berman might see it as good that economic analysis is subordinate to political decisions. But economists often lose policymaking fights for causes that she would support, including more regulation. In 2014, when the Council of Economic Advisers analyzed emissions limits on power plants for the Clean Power Plan, a governmental initiative to cut carbon emissions, we found that the marginal benefits of stricter limits so greatly exceeded the marginal costs that the Environmental Protection Agency's proposed regulations were too weak. But the EPA rejected our support for more ambitious targets. Understandably, the agency's staff was more attuned to the possibility that our ideas would be vulnerable in the courts—a judgment that we fully accepted.



The U.S. Council of Economic Advisers testifying before Congress in Washington, February 2022
Sarah Silbiger / Bloomberg via Getty Images

Climate change is, more generally, an example of an area where the problem is not that economists are too powerful but that they are not nearly powerful enough. To my knowledge, the largest open letter ever written by economists—eventually garnering more than 3,500 signatories from across the political spectrum—was the one published in *The Wall Street Journal* in 2019 arguing that the United States needed a carbon tax and dividend. The emissions reductions associated with this proposal would have been substantially larger than what Congress considered last year as part of the Build Back Better plan. That plan, by contrast, included a set of climate ideas that was developed mostly without the type of economic reasoning that Berman disapproves of.

Berman, of course, wants aggressive emissions reductions—along with a host of other left-leaning policy shifts. But she argues that governments should make these changes through a process that's based on fundamental human rights and universality rather than arriving at them by wallowing through the details of quantitative analysis and tradeoffs. She advocates for more command-and-control regulation in climate policy: "the strategy of simply instructing government to determine safe levels of emissions and requiring firms to meet them, as Democrats might have proposed in the 1970s." This type of regulation, she bemoans, "was not even discussed" during the Obama administration.

Although foregrounding fundamental rights may make for appealing political slogans—and sometimes those rights may indeed win the day—it can be a poor way to design economic policies that make people's lives better. Take pollution. Berman writes favorably about rules grounded in the "implicit belief that pollution was morally wrong and therefore punishable." That concept sounds attractive, but it is an impossible basis for public policy. The world cannot immediately eliminate all carbon emissions, and attempts to do so would run up against a different set of principles: that it is morally wrong to destroy jobs for low- and moderate-income workers or to raise the cost of everything they buy. To properly phase out carbon emissions, states have to engage in some cost-benefit research and distributional considerations. In other words, they need economic analysis.

Economic research is invaluable in other areas of policymaking, such as social welfare spending. Many activists support universal payments to a society's residents, regardless of wealth, both on moral grounds and because they believe it increases the political sustainability of policies. But both of these rationales have shortcomings. For the same amount of money, the U.S. government could either give $10,000 to the bottom quarter of households or give $2,500 to all households. The former would do much more to reduce poverty, and it may be even more politically secure. Contrary to popular belief, more targeted programs have, if anything, proven hardier than universal ones over time. Low-income programs such as the Earned Income Tax Credit, Medicaid, and those that provide nutritional assistance have all been expanded multiple times under both Democratic and Republican presidential administrations, while universal programs, such as unemployment insurance, have languished. Even Social Security and Medicare—the United States' two most famous universal welfare programs—have experienced budget cuts.

ON THE LEVEL

Part of Berman's skepticism of economic policy stems from her belief as a sociologist that the evolution of economic thinking is driven not by advances in theory and evidence but by the interests of the powerful. When discussing the evolving ways economists think about issues such as curbing pollution, reducing poverty, or understanding the consequences of larger businesses, Berman keeps a strong focus on the institutions that developed and advanced these ideas and the interests those institutions served.

For example, she quotes a lawyer trained at the University of Chicago who fundraises for a summer program that instructs judges on antitrust issues. “The [corporate] world knew that Chicago economics was the only thing that could possibly save them from an antitrust debacle,” the lawyer says. “Of the eleven [major corporations] I wrote

them, and the last $10,000 came in a few weeks later.”

Although economics has major limits as a science, a lot of the changes in its principles really do reflect improvements in research. Many of the first advances in antitrust regulation, for instance, resulted from the genuine progress of ideas. The discipline’s initial approach to competition policy, developed in the 1930s, held that regulators could look at the number of firms in an industry (which was taken as fixed and given) and neatly infer the impact it would have on prices and consumers. As a rule, then, economists concluded that consolidation would clearly lead to higher prices, a line of thinking that inspired vigorous antitrust enforcement.

But in the 1960s, an increasing body of studies found that this theory was incorrect. In some cases, consolidation created more efficient and more competitive firms, resulting in lower costs for consumers. It turned out that overzealous antitrust enforcement sometimes increased prices. (One particularly notorious example came in 1967, when the Supreme Court held that national bakeries could not sell inexpensive frozen pies in Utah because they undercut the state's main pie company.) As the evidence poured in, economists began to discard "the Brandeisian approach," named after the legal theorist Louis Brandeis, which views big companies as inherently problematic and understands the goals of antitrust policy to include protecting small businesses and democracy more broadly. Instead, they embraced a more lenient philosophy that would help consumers. The federal government and judiciary followed suit, allowing mergers and acquisitions to proceed with renewed pace.

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Now, however, it is clear that regulators and the courts overcorrected, growing too lax about antitrust enforcement, which led to an overly permissive attitude toward everything from hospital mergers (which have increased medical costs) to technology mergers (which have stifled innovation). But the problem in these cases was not the influence of economics. It was that policymakers did not take economics seriously enough. Powerful interests had greatly oversimplified nuanced economic research—always replete with examples in which the mere threat of a new company entering a market and competing with the dominant incumbent was not sufficient to protect consumers from abuses—to train a generation of judges in an excessively narrow, free-market approach. More recent economics research has made it even clearer that there are limits to the efficiency gains from mergers, that vertical integration (in which one company takes control of multiple parts of a single supply chain) has costs for consumers, and that too little competition can reduce quality and innovation. These are all critical findings, ones that policymakers should heed and that give progressives ammunition. These findings suggest that rather than blame economists for bad competition policy, liberals should team up with them.

Indeed, critics of the economic approach would be surprised by just how progressive the field can be.

Economics itself has a strong radical tradition, grounded in something that Berman correctly describes but mistakenly laments: its "unrepentantly utilitarian and consequentialist" theoretical underpinnings. At their core, these philosophies hold that the best societal outcome is one in which everyone is equal—so long as the process of achieving equality does not result in people being much worse off—and they have been critical to advancing liberal causes. These schools of thought are what led the economist Adam Smith to oppose slavery and support labor unions, the political theorist John Stuart Mill to champion women's right to vote, and the philosopher Jeremy Bentham to be an early strong proponent of LGBTQ rights in 1785. No wonder utilitarian consequentialism has been the basis of peer-reviewed articles in leading economics journals that endorse a top marginal tax rate of 70 to 95 percent.

Consequentialism is also what forces people to take the side effects of a policy seriously—to look at how climate regulation affects not just carbon emissions but costs for consumers or how a universal program and a targeted program may affect poverty differently. Perhaps the best example of how consequentialists think about side effects is economists' comfort with putting a statistical value on human life (currently about $10 million in U.S. regulatory analysis). This strikes noneconomists, including Berman, as abhorrent. But if governments fail to consider the cost of lives, they can't save as many people as possible when making life-or-death decisions. Numbers may seem cold and brutal, but they can be a tool for tremendous good in a world where tradeoffs are inevitable. If policymakers aren't explicit about these tradeoffs and their respective costs, they will make choices that are too costly in either blood or treasure.

GETTING REAL

Berman's critique is not entirely off base, however. She is right that powerful interests can sometimes capture economic policy, as in the overcorrection of antitrust policy. As a discipline, economics needs to do a better job of influencing public policy so it reflects unbiased analysis—not whims and power relations. Economists must also keep their recommendations up to date and rigorous rather than rely on whatever was in the textbooks 50 years ago. For example, instead of endorsing financial programs for the elderly, economists should advocate for more investments in children, including through more unconditional cash payments, based on the reams of newer empirical evidence showing very high returns on these investments. Expenditures that improve children's health, for instance, increase economic growth by more than enough to cover their initial budgetary cost.

Economists must also do a better job of evaluating political realities when assessing and pushing policies. The best ideas are often simply not feasible, and although economists must make sure they present regulators and lawmakers with the strongest overall concepts, they must work hard to devise effective policies that are also politically tenable. Just like progressive purists, who prefer glorious losses to pragmatic compromises, too many economists also choose to oppose imperfect ideas instead of soiling themselves with the task of crafting the politically achievable second best. In climate policy, for example, it is clear that a carbon tax is the best way to curtail emissions. But it is also politically impossible in the United States, and U.S. economists must focus on proposals that can actually become law.

To understand the political dynamics of

policymaking, economists can learn from sociologists. Economics tends to focus on outcomes, but sociology has shown that processes are also tremendously important for determining how people and communities handle and understand policy changes. Economists need to better recognize that humans care deeply about their personal stories and histories, and they must learn that communicating policy decisions in a way that makes people feel valued, heard, and cared for is just as important as the policy decision itself. Economists must also more broadly understand that their discipline is only one way of thinking about the world. When I teach my students about discrimination, I use bloodless technical terms like "taste-based discrimination" (bias that stems from personal preferences) and "statistical discrimination" (bias that stems from one's assumptions about a group of people). But I also tell them to study the issues through the prisms of history, political science, literature, art, and, of course, sociology. These subjects all also offer tremendous findings and insights that my colleagues and I should take seriously.

That doesn't mean the world needs less economic analysis; the discipline remains critical. Economists should certainly highlight what critics like Berman get wrong, including the presumption that their field is simply a tool of the powerful, or that it is all-powerful. But economists can also prove their value by working collaboratively and doing less to provide opponents with ammunition. Economic analysis alone is not enough—either for devising the right policies or for bringing those policies into existence.

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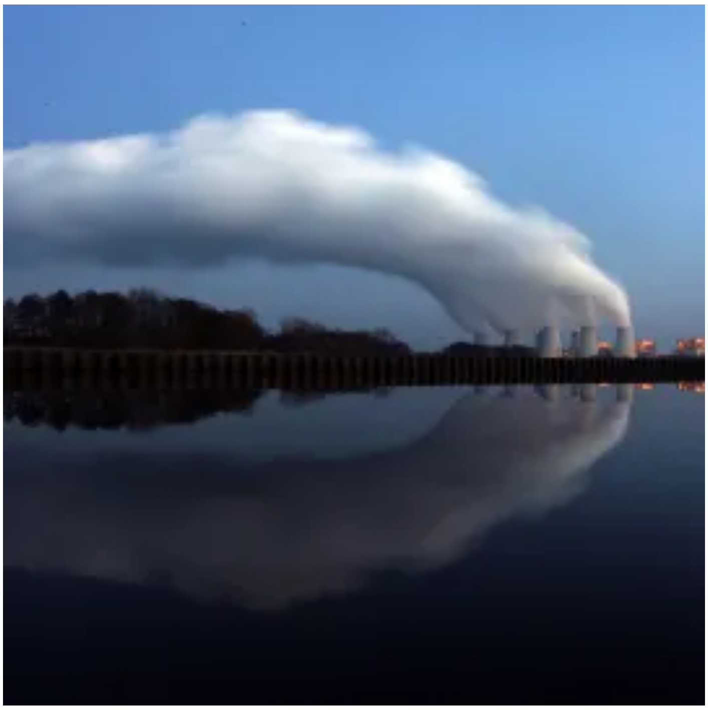

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