

What Good Are Economists, Anyway?

Darn good, according to *Trillion Dollar Economists*

Trillion Dollar Economists: How Economists and Their Ideas Have Transformed Business

By **Robert E. Litan***

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400 pages

Reviewed by **John Yanish**

Vice President and Deputy General Counsel

Federal Reserve Bank of Minneapolis

A few years back, a T-shirt worn by economics graduate students at the University of Minnesota read, “Sure, it works in practice, but how does it sound in theory?” In light of the recent financial crisis and ensuing years of economic challenge, that ironic academic poke arguably leads to a more serious question: “For all their theories, do economists add much value in the real world?”

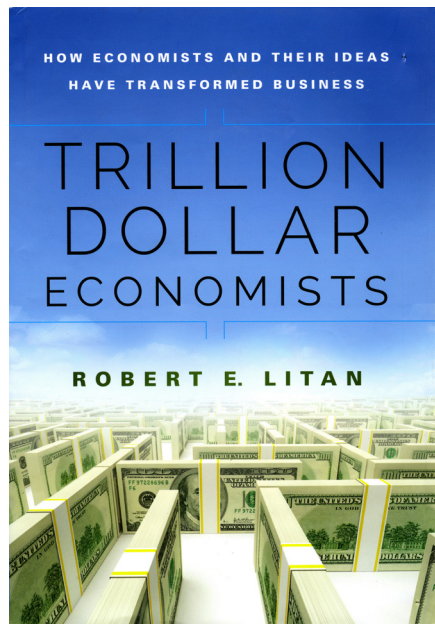
Robert Litan, an economist, lawyer and senior fellow at the Brookings Institution (see bio below) answers that question with a resounding yes in his most recent book, *Trillion Dollar Economists*. Indeed, Litan portrays economists as unsung heroes who have created enormous value in business and a wide range of day-to-day activities, from investing to air travel, energy policy, online dating and beyond.

The book is unconventional in many respects. It’s completely devoted to economics, but the author consciously writes for those who know little or

nothing about it. An opening chapter is laid out as a primer on basic economic principles (e.g., micro versus macro) designed to give the otherwise uninformed reader a baseline of knowledge. Litan then leads readers, armed with those fundamentals, on a whirlwind journey through real-world examples. The journey’s destination: Economists and economic theory have “created trillions of dollars of income and wealth for the United States and the rest of the world, hence the title of the book.”

One surprise is the book’s lack of focus on monetary policy. Although Litan has kind words at various points for Ben Bernanke, Paul Volcker and others who have shaped monetary policy over time, he gives little attention to Federal Reserve policies or other macroeconomic matters. Indeed, he laments that, in his view, most people are under a mistaken impression that economists focus their efforts on trying to determine the future trend of the economy, as the Fed does when setting policy. He states early on: “The truth is that relatively few economists actually engage in economic soothsaying or prediction. Yes, let me repeat that, or phrase it in a slightly different way: The popular perception of what most economists do is wrong, and I intend to show that in [this book].” Litan’s central point: The unrecognized extraordinary value of economists is their direct (or near-direct) contribution to daily business practices and other matters of common interest.

***Robert Litan** is a nonresident senior fellow at the Brookings Institution, where he formerly was senior fellow, vice president and director of economic studies. A professional economist, practicing attorney and prolific writer, Litan has authored or co-authored over two dozen books, edited many more and written scores of articles, reports, commentaries and reviews for professional and popular journals. He gives frequent speeches; testifies regularly before Congress, often on issues related to regulatory reform and/or banking; and has worked at nonprofit, corporate and government organizations and agencies. He earned his J.D. at Yale Law School and his Ph.D. in economics at Yale University.



The bulk of *Trillion Dollar Economists* is devoted to examining what the author believes are examples of real-world successes driven by economists and economic theory. One such case: efficient air travel. The author reminds readers of years past, when airlines routinely “bumped” ticketed passengers from overbooked flights. Recognizing (finally!) the tremendous ill will this generated among paying customers, airlines began to leave seats empty (thereby losing revenue) to avoid having to bump. But doing so, of course, cost airlines the revenue those empty seats could have generated.

Enter economic theory. Litan relates how economist Julian Simon and others helped airlines avoid the issue by using an auction, the now familiar practice of offering vouchers for future travel to passengers willing to voluntarily forgo the overbooked flight in favor of a later flight. This low-cost practice eliminated ill will, allowed fully booked flights and, according to Litan, increased airline revenue by \$100 billion over the past 30 years.

Building off that example, the book provides a range of other success stories brought about by economic theory. Index investing, the now-popular practice of investing in a very broad range of stocks rather than attempting to pick individual

“winners” is a typical Litan case study. In the following excerpt, he traces index investing directly back to the influence of several economists on the mutual fund industry with informal, accessible storytelling style:

Ideas can have real-world commercial impacts in many different ways. Sometimes, entrepreneurs and executives at established firms read a book or article with a clever idea and they proceed to make it operational. Others get commercial ideas from economists they hire as consultants. And frequently, as you will see in this book, entrepreneurs are motivated by an economic idea they learn while attending school.

John “Jack” Bogle, the founder of the Vanguard family of mutual funds, is a prime example of the last way economists have had an impact. Bogle reports that he was heavily influenced by both [Burton] Malkiel and Paul Samuelson ... two of the champions of indexing and critics of active money management, especially by individual investors, both in writing his senior thesis at Princeton on the idea of index funds and then actually implementing that idea at Vanguard.

According to Litan, when the remainder of the mutual fund industry followed suit, this new-found practice not only made investing simpler for the average individual, but yielded superior results and “transformed the investment world.”

Litan relates similar positive contributions to energy policy (lower prices after economic theory established the ineffectiveness of mandatory price controls), sports (econometrics help team owners find value, as depicted in the book and movie *Moneyball*) and online dating (economic game theory yields better matches).

While making his case, Litan also provides dozens of profiles of individual economists, amounting to a type of Hall of Fame from the author’s perspective. This feature, along with Litan’s low-key, “this is not about me” presentation style, adds to the book’s charm. It is clear that the author has genuine admiration and, in some cases, personal affection for the economists he profiles, many of whom were colleagues or had otherwise influenced his own career.

The book isn't without flaws. At points, such as his detailed description of the rise of telecommunications and the Internet, Litan seems to stretch too far. He details at great length contributions made by economists to important developments, such as providing economic analysis to support the legal case regarding the breakup of AT&T, which set the stage for greater competition in the field. While this and other efforts by economists had substantial impact, it is a far reach to extrapolate from these events to arrive at Litan's statement that "it is no overstatement to claim that the modern Internet-based business landscape of today owes much of its shape, if not existence, to the behind-the-scenes thoughts and research of numerous economists." An argument that, but for economists, we wouldn't have the Internet seems to go beyond the evidence provided.

This generous portrayal of economists contrasts with Litan's take on the Wall Street activities that sparked the recent financial crisis. He seems to suggest that economists had little if anything to do with shaping risky investment practices and strategies. While this might be valid, the reader is left with the sense that the landscape is being selectively reviewed, with an eye toward taking credit for the good and, as for the bad, giving economists the benefit of generous doubt.

That said, *Trillion Dollar Economists* makes an interesting contribution to a discussion of the relative merits of the economics profession. As a non-economist, and therefore a member of Litan's target audience, I found the book a challenging read, but worth the effort. The writing, while not always elegant, is ultimately digestible, even if concepts like regression analysis, performance optimization and congestion pricing remain a bit fuzzy. I finished the book largely convinced by his case for the value economists have added, in both business and other activities not associated with the field.

Ironically, economists are likely to be the audience that would most enjoy this book intended for non-economists. Those knowledgeable in the field would no doubt understand Litan's arguments better than lay readers, would be familiar with the economists he lovingly profiles and would certainly enjoy the accolades he showers on the profession. A potential problem, though, for the humorous T-shirt slogan business? "Sounds good in theory and works in practice" just doesn't have much punch to it. **R**