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'Good Economics for Hard Times' Review: Sticky Markets, Tricky Solutions

Free-market advocates often assume the free mobility of labor. The truth is that people don't move so fluidly. Markets can be sticky.



Free-market advocates often forget that labor markets can be sticky. PHOTO: CHRIS MADDALONI/ROLL CALL/GETTY IMAGES

By William Easterly

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Proponents of market reforms are quick to tout the benefits that markets have to deliver. But as Abhijit Banerjee and Esther Duflo, two of this year's Nobel laureates in economics, repeatedly show in "Good Economics for Hard Times," some apologists have a tendency to overpromise. Markets, the authors remind us, can be sticky. Pro-market reforms like freer trade, for instance, only work as well as advocates predict when people can freely move to better opportunities.

In reality, people don't move so fluidly to new industries or regions. The authors cite a 2013 comparative study of regional labor markets in the U.S.—regions defined by commuting patterns—that were affected by the expansion of Chinese trade between 1991 and 2007. The study showed declines in total employment in the American regions hardest hit by Chinese competition. This should not have happened if workers had simply moved within the same region to an industry that benefited from cheaper imports. Workers could have also, in theory, moved to an expanding region from a declining one. But workers do not move easily, even when

an expanding region is nearby. A 2010 study of labor mobility in India following trade liberalization in 1991 found a similar result of people stuck in declining districts. Yet another study, from 2014, found a different kind of immobility in Bangladesh, where people in rural areas did not migrate to cities as much as predicted by the urban-rural wage discrepancy.

In contrast to such “bad economics,” Mr. Banerjee and Ms. Duflo offer the “good economics” of policies that take such stickiness into consideration. The authors are not trying to get rid of markets. They recognize Venezuela as an example of what happens when markets are distorted by price controls and hyperinflation. They warn that a trade war with China would create a new list of losing American regions. They also admit that removing drastic measures such as state ownership and central planning—as China, India, South Korea and Vietnam have done to varying degrees—delivered much higher economic growth.

Consider the fisheries in the coastal state of Kerala, India. In the past, as the fishermen completed their catch offshore they would head to their nearest fish market, flooding some areas with product while elsewhere customers would go away empty-handed. It was a serious misallocation of resources. The stickiness, in this case, was a lack of information. Once cellphone technology arrived in the region, fishermen could call ahead and locate those markets with the most customers. Sticky markets corrected.

Great so far, but then the book takes some wrong turns. In calling for tax increases, for instance, the authors recommend engaging “the best minds in the world to work with governments . . . to redesign our social programs for effectiveness.” For the U.S. in particular, “the only possible way out involves a much expanded role for the government.” This isn’t merely introducing cellphones to fishermen.

Would such a big redesign really work? Take one program the authors celebrate for having overcome stickiness: the federal government’s 1994 Moving to Opportunity program, which offered residents of high-poverty public housing a chance to move to low-poverty neighborhoods. The early results showed little payoff for the program’s beneficiaries, but 20 years later researchers found strong positive effects on earnings and college enrollment for the children of parents who participated in the program. How do you redesign policies for effectiveness if you won’t know whether something works until 20 years later?

The authors also acknowledge that there will be disagreements about solutions. Do you subsidize the U.S. regions that have lost out from trade with China? Or do you target assistance at people rather than places? Politicians and voters are also unlikely to select policies based on what the academics recommend. In the U.S. and the U.K., the public does not seem to vote as much for redistribution as the authors would want them to. In fact, the authors note that, in U.S. and U.K., polls have shown only about 25% of the public trusts economists.

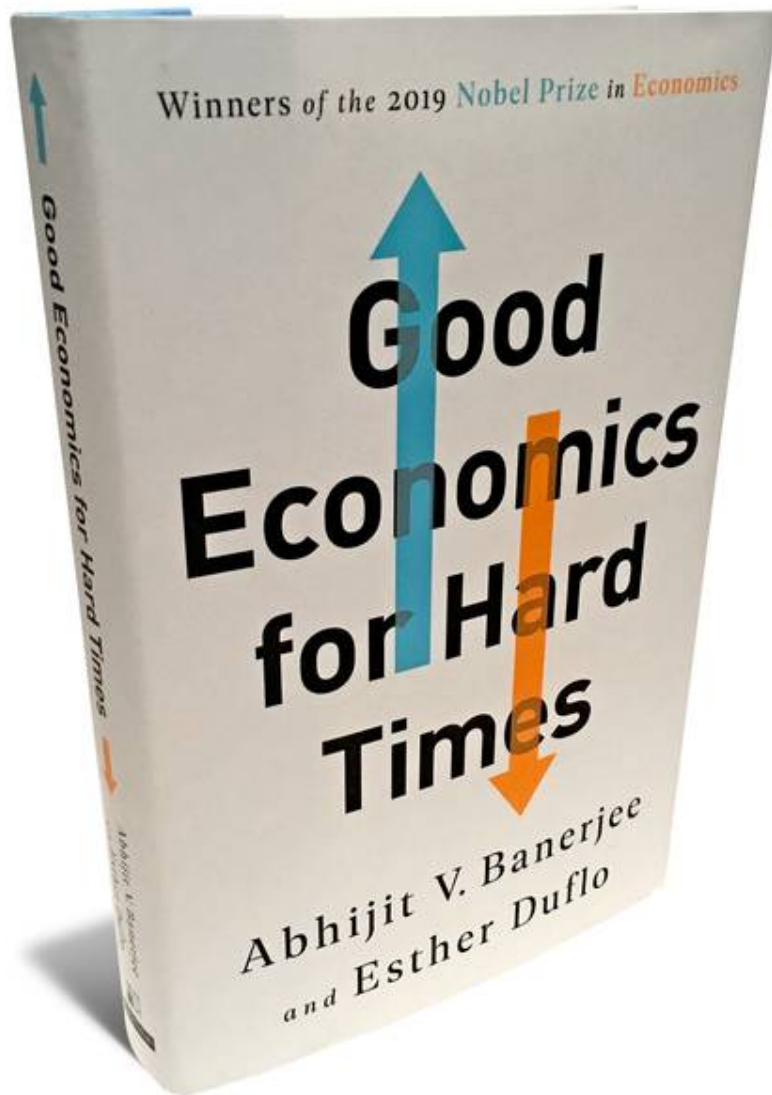


PHOTO: WSJ

GOOD ECONOMICS FOR HARD TIMES

By Abhijit V. Banerjee and Esther Duflo
PublicAffairs, 403 pages, \$30

Unfortunately, the book's tone does not help foster trust. The authors originally hoped to address a "growing polarization" because policy debates have become "a high-decibel slanging match." They say their job is "to offer facts" that they hope "will help mediate these divides . . . and thereby arrive at some reasoned disagreement [with] respect on both sides."

Yet the authors themselves struggle to manifest this respect. They engage in some ad hominem arguments, discounting their opponents' views if they have appeared on television or in the press, if they work for the private sector, are "strident" or belong to "a previous era." The authors don't identify by name those doing bad economics, except for an attack on "nine conservative academic economists, mostly with solid reputations but also part of this older generation." The authors feel that their opponents suffer from "ignorance and ideology" because they "often feel free to ignore the weight of the evidence." For their own arguments, the authors appeal to the authority of "recognized leaders in the profession," also known as "today's best economists."

In October, Mr. Banerjee and Ms. Duflo, together with Michael Kremer, won the Nobel Prize for their work on evidence-based policy in economic development. "Good Economics for Hard Times" lives up to its authors' reputations, giving a masterly tour of the current evidence on critical policy questions facing less-than-perfect markets in both developed and developing countries, from migration to trade to postindustrial blight. But the book is less convincing when it suggests that a wholesale redesign of social programs is a viable or desirable replacement for our messy democracies and sticky markets. The evidence is lacking for such an ambitious evidence-based policy.

Mr. Easterly, a professor at New York University, is the author of "The Tyranny of Experts: Economists, Dictators, and the Forgotten Rights of the Poor."

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