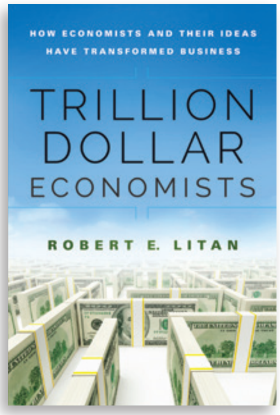
BookReview

Valuing Economists



TRILLION DOLLAR ECONOMISTS: HOW ECONOMISTS AND THEIR IDEAS HAVE TRANSFORMED BUSINESS
BY ROBERT E. LITAN
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REVIEWED BY DAVID A. PRICE

In 1951, rhythm and blues singer Louis Jordan posed the musical question, "If You're So Smart, How Come You Ain't Rich?" Economists have been on the receiving end of that question in the decades since. Brookings Institution economist Robert Litan, in *Trillion Dollar Economists*, implicitly offers an answer: Just as Thomas Edison captured only a minuscule share of the value of the light bulb, the value created by economists has flowed to companies and to society at large.

Writing in a breezy, conversational style — he says he was inspired by the *Freakonomics* books — Litan argues that the ideas of economists have been crucial to improving the performance of firms and creating the business models of new ones. After a brief introduction to a few of the field's big ideas, such as marginal analysis and market failure, he sets out on a tour of industries that have directly benefited, he says, from economists' insights.

Some of those insights involve strategies for price-setting. Students of economics might assume every firm is among the beneficiaries here, with all of them relying on the lessons of microeconomics 101. But no: Litan concedes that at least for new products, economic theory gives a firm relatively little practical information about where to set prices. "The best you can do is price by trial and error, or you can fix a price and add more value to the product or service over time and hopefully convince customers to buy it."

What Litan does point to are more specific applications of economic theory to price-setting, especially in the context of auction design. Clever economic ideas about auctions, of course, have built fortunes. Litan recounts the creation of Google's algorithm for auctioning its online ads, in which the winner pays a penny more than the second-highest bid (to simplify somewhat) — an algorithm that has long powered the company's financial engine. Based on its experience with ad auctions, Google also used a novel auction process to sell its shares when it went public in 2004. The travel booking company Priceline patented an auction-like process, the "name your price" conditional offer, and employed it to help hotels and airlines sell unsold space to the most price-sensitive travelers. Litan notes that the concept of price discrimination, charging consumers different prices for the same product based on their price sensitivity, was itself the work of a University of Cambridge economist, Frank Ramsey, as well as others who built on his research.

Other areas of business innovation — and policy innovations beneficial to businesses — that Litan credits in whole or in part to economists range from index-based mutual funds to the design of more efficient dating "markets" for dating websites to the deregulation of trucking, airlines, and energy. Looking ahead, he foresees the resurgence of prediction markets and expresses hope for the adoption of financial engineering to support medical discoveries (in particular, "research-backed securities" to fund testing of drugs and earn royalties on the successful ones, an idea proposed by Andrew Lo of the Massachusetts Institute of Technology).

A mildly disorienting aspect of *Trillion Dollar Economists* arises from Litan's benignly imperialistic view of economics. Although his stated mission, in part, is to see that economists get due credit for their "largely overlooked" contributions, many of the innovations he describes did not actually come from economists — as he makes clear. For instance, although the method behind Google's ad auctions was previously the subject of Nobel Prize-winning work, Google engineers developed it independently. Some other areas on which he reports, such as big-data analytics, are mainly the provinces of statisticians.

Presumably Litan's view is that these individuals fit his argument because they have been practicing economics even though they aren't economists themselves. But then his argument seems to become almost tautological: If one views anybody whose ideas influence business as a practitioner of economics, it isn't surprising that one would conclude practitioners of economics have influenced business.

Regardless of whether Litan's examples necessarily support his claims for economics, his thesis is accurate: Economists and their ideas *are* influential in business. Certainly they're well represented. According to a 2006 paper by Patricia Flynn and Michael Quinn of Bentley College, economics is the third most common major among large-company (S&P 500) CEOs, after business administration and engineering. The top 20 U.S. business schools in 2003-2004 had over 500 economists on their faculties teaching future business and finance leaders. A National Science Foundation survey in 2013 found that 19.3 percent of economics Ph.D.s work for companies directly. A number of prominent technology companies have economic researchers on staff, including Google, Microsoft, eBay, and Airbnb.

Besides correcting what he sees as underappreciation of economists' roles, Litan notes that he has another agenda — namely, to set out a late-career statement of affection for the field and its people. Economists and non-economists alike will probably find his enthusiasm infectious. **EF**