

A Review of the Book: Good Economics in Hard Times

- Published on November 3, 2020



Wes McComb, MBA, CIM, PFP

Advisor to High Net Worth Clients

Good Economics in Hard Times is a fascinating book. It was written by Nobel Prize winning couple, Abhijit V. Banerjee and Esther Duflo, and focuses on important topics such as; trade, immigration, taxes and productivity. I found this book to be very informative and it has even managed to shift my views somewhat. Not every book I read can make that claim.

As I continued reading through it, I realized that I may actually be moving to a more centrist stance in my fiscal views. My younger self would be amazed and possibly repelled by this slow transformation. New research has come to enlighten some of these topics that have become political and social lightning rods as well as economic topics of inquiry. Every chapter offers nuanced approaches that exhaustively cover the current and past research of each subject. These details can persuade a disinterested reader to look at the matter in a new light. Not all of the book's arguments were unanswerable but one needs to have a firm opposing view, with good counterpoints, to remain unimpressed by the author's thesis.

Immigration has different connotations to people, depending on where you live. In Europe, it seems to evoke a negative reaction with the streams of refugees trying to get onto the continent. They also don't have the same history of successive waves of immigration and the eventual absorption that the Americas have. The US has its own issues with it as we know with the talk of The Wall. But they are a land of immigration and still attract many of the best and brightest people to their country.

Here in Canada, we do get a bit smug about our policy of bringing in nearly 1% of the population into our country per year. However, because of our geographical location, we don't have to contend with the same number of uneducated, low skilled refugees who don't speak either official language. We also have been accused of skimming off the best and brightest from the developing world leaving these countries robbed of their future leaders.

What the authors do show, is that even the low skilled, uneducated emigres do benefit their new homes. These often scapegoated people don't take jobs but provide jobs to the indigenous low skilled workers because they still spend their money local, everyday services provided by the native population. This is the type of information that needs to be more widespread. "Stealing our jobs" is often the mantra of those opposed to immigration.

The topics of trade and immigration begin to overlap when the authors discuss the dislocation caused by trade. Trade is always portrayed as a panacea for all of our ills. I have been a believer and a beneficiary of free trade since my 20s when the first trade deal with the US was signed in 1988. To be clear free trade is good overall. However, it does cause significant dislocation for many workers when entire industries disappear because of new competition. With much economic theory predicated on the assumption that these newly unemployed will move to where there are jobs, we begin to see that theory and reality don't always meet. The US rust belt and Appalachia are obvious examples. The unemployed there didn't always move to new communities for many reasons and chose to remain where they were, adjusting the best they could. So, though open trade is an overall good, not everyone benefits and many suffer for it.

This is also the author's argument about immigration not being a threat to more open borders. Since many of these workers in these economically disadvantaged American areas did not move, the worry about people from other countries overrunning a host country with open borders is less of a concern. The logic of this argument is that since Americans won't even move to a culturally similar town a few hours away, an immigrant without the local language or cultural knowledge won't up and leave their country unless there is an existential threat. I have my doubts about this part of their reasoning. It would only be rational for a person living in a significantly poorer country to move to a much wealthier one and this would continue until the wealth arbitrage was reduced to the point where moving had a social cost equal to any economic gain.

Tax policy is an area of study that I thought had been thoroughly researched and that our current system was, if not ideal, close to it. My assumption should not be considered outlandish considering how much discussion there is about taxes and the consensus with almost everyone employed in the private sector that high taxes are bad. The quote from Margaret Thatcher "the problem with socialism is that you eventually run out of other peoples money" is always just below the surface, waiting to reappear whenever taxes or increased government spending hits the headlines. After all who is better able to decide how my money should be spent, myself or a bureaucrat? But according to Banerjee and Duflo, there needs to be a reassessment of these maxims since recent research seems to indicate otherwise.

They argue that even with the extraordinary fortunes being created in the technology sector very little tax is being paid. This is because capital gains taxes are not paid until a sale takes place and with good tax and estate planning this disposition may never occur, so the government never gets a portion of this wealth. I agree with this, as do investors like Bill Gates and Warren Buffet. There should be some mechanism created so that we

all get to share through taxation an agreed upon amount of this excess largesse of the extraordinarily fortunate. We can argue what amount is "extraordinarily fortunate" but accumulated wealth of over 100 million dollars would be a defensible starting point.

The part of the professors' argument about taxes that I have more of a dispute with is when they state that really high income taxes on the middle and upper middle classes won't have serious economic consequences. I would dispute this on two points. The first is that there is an implication that saving is bad. They believe that individuals with lower incomes will spend all their money which will drive the economy. I think there has to be a defense made for middle class savers. This is the money that helps new startups, capital for business investment and allows governments to borrow at such low rates. These savings, in the majority of cases, are also taxed at some point because RRIFs are fully taxed at the death of the second spouse. Capital gains will be levied on savings outside of registered plans since the middle class doesn't have access to the tax and estate planning of the uber wealthy. The second point is that incentives have to have some influence on behaviour.

Banerjee and Duflo believe that tax rates of over 70% on income will not be a disincentive on hardworking people. Even if this is the case and workaholics continue to be workaholics, these excessive tax rates will cause more extensive tax avoidance.

For example, the Trudeau government's increase in the highest marginal tax rate was expected to yield 3 billion dollars in new taxes but has now settled in at 1 billion dollars per annum 3 years after the tax increase.

The authors have interesting discussions on other topics such as global warming, what spurs GDP growth (nobody seems to know) and other economic issues. They are humble in assessing what economics are able to provide. They have not given up on the dismal science and offer hope that it may provide better answers as we accumulate more research.

This hope that economics will give us answers to the many difficult, and in some cases seemingly intractable, topics is often dismissed by those in the hard sciences such as physics and chemistry. But the dismal science is slowly moving away from their econometric models and accumulating some astounding real world data that gives us hope that we can move away from the politics of these topics to making decisions based on empirical information. Plus, what is more fascinating than studying humans interacting with real world with the goal to making all of us better off.

The information contained herein was obtained from sources we believe to be reliable, but is not guaranteed by us and may be incomplete. The opinions expressed are based on our analysis and interpretation of this information and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein. The opinions expressed herein are those of the author and do not necessarily reflect those of National Bank Financial. The securities or investment sectors mentioned herein are not suitable for all types of investors. Please consult your investment advisor to verify whether the securities

or sectors suit your investor's profile as well as to obtain complete information, including the main risk factors, regarding those securities or sectors. This document is not a research analysis produced by the Research Department of National Bank Financial. National Bank Financial is a subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange (NA: TSX).