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For Young College Students, the Case for Economics

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Economics is more than business. It's about setting the rules in the first place. That requires both a different toolkit and a different worldview.

Five years ago, top Harvard College graduates flooded Wall Street. They were small cogs in a race-car engine, except the car was speeding over a cliff. It's no wonder that today's graduates are reconsidering their career choices.

They should start with economics.

When most people think about economics, their minds turn to business and finance. But economics goes beyond these fields, and the difference between business and economics goes beyond size. Economics is about a way of thinking.

Wal-Mart, for example, has roughly two million employees, more than the population of some fifty countries. Success in business, for Wal-Mart, or any company, is about navigating the rules of the game at hand. Economics is about setting the rules in the first place. That requires both a different toolkit and a different worldview.

It has become acceptable, in casual conversation, to say that markets don't work. The demise of Lehman Brothers and the subsequent swoon of the global economy are often cited as evidence. The next time you hear someone say this, you can tell them they're wrong for two reasons: Lehman Brothers is more a symptom of what happened rather than the underlying cause, and it was guided by much larger forces than itself. Markets, in fact, work all too well. They are an aggregator of wishes and desires, however misguided they may be.

Chuck Prince, the former CEO and chairman of what was once the world's largest bank, was right when he uttered these famous words shortly before his resignation: "As long as the music is playing, you've got to get up and dance." Place the emphasis on "you've got to." Legislators and regulators, in their finite wisdom, had erased many of the existing checks and restrictions—those few, rickety road signs pointing in different directions. Their actions lit a fire under Prince's and other bankers' feet.

This is not to vilify Prince. He had it right. Bankers should be dancing to the music. That's what they're paid to do (and very well at that). It's also the core lesson they're taught in business school: Find the best ways to navigate the current system and make a buck or two in the process.

It's up to the rest of us to find the right rhythm. That's where economics comes in.

The caricature of economists is one of free market apologists. It's understandable. One need only look at Alan Greenspan and others who hew too closely to Ayn Rand's fictional characters. But this caricature is also unfortunate.

Today, we are far from having anything approaching a free market. Fossil fuel subsidies and various other loopholes and distortions make the playing field uneven. More significantly, we violate one of the most basic tenets of economics, that there is no free lunch. In reality, it turns out, we all get a steady stream of free passes.

It starts in the financial sector, where the benefits of bankers' actions are often and almost entirely privatized: They pocket the bonus if the bet pays off. But the costs are socialized: Bankers pay but a tiny fraction of the costs of their failed bets; society pays. The fundamental mismatch, as evidenced by the collapse of Lehman Brothers, has enormous consequences for the rest of us.

This still pales in comparison to privatizing the benefits of our daily economic activities and saddling others with the pollution costs. A ton of coal and a barrel of oil consumption cause more damage to human health and the economy than the value they add to gross domestic product. That's in stark violation of the "no free lunch" principle and leads economists of all stripes—from Paul Krugman to N. Gregory Mankiw—to call for polluters to pay. The difference lies in the degree of emphasis.

Mankiw's popular introductory economics class at Harvard and his bestselling textbook talk about economic inequality and pollution, but both books take a while to get to the point. Any good macroeconomics class would feature the fundamental welfare theorems—why and how markets work—near the beginning of the semester. But these classes should also jump immediately to when and how markets fail—not as rare exceptions but as pervasive phenomena.

Market failures, by the way, should not be confused with moral failures, which can be rectified if we only do the right things as individuals. Your dedication to recycling won't make the planet notice. The response needs to be collective, and it needs to be guided by someone outside the system looking in: economists.

Economists' regulatory responses, by their very nature, will often stick closely to market principles. Shoppers don't consider the full life-cycle implications when they get a free plastic bag at the checkout counter, nor should they. But the answer isn't to ban disposable bags altogether. The answer is to charge a tiny "PlasTax," which decreased plastic bag use in Ireland by over 90 percent or a billion bags a year. A similar fee is already doing wonders in Washington, DC. The same principle goes for reining in pollution from airplane travel or most anything else, for that matter: Don't limit choice, enable consumers to make the right choices without even thinking about them.

But, just as there are pitfalls for business, there are traps for economists as well. Goldman Sachs has canceled campus recruiting events because of protests. That might have been a symbolic victory for student offshoots of Occupy Wall Street, but it has little to do with changing the system. Occupy Harvard's organized walkout of Mankiw's economics class is more consequential. I disagree with the method if not the sentiment. Economists ought to be more humble in what we know and how we teach it.

Still, "economics is organized common sense," as Tom Sargent, this year's winner of the Nobel Prize, remembers Jerry Kenley, the teaching assistant who inspired him to take up economics, saying. Kenley is right. If there is anything we need right now to guide our economy and the planet out of this dual malaise, it's more common sense.

Gernot Wagner is the author of But Will the Planet Notice? How Smart Economics Can Save the World. He teaches at Columbia University and is an economist at the Environmental Defense Fund.

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