The Role of the Economic Scholar in Highly Politicized Society

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Thank you. It's an honor to be with you this evening.

Let me immediately state my conclusion about the role of the economic scholar in highly politicized society: *stick to principles*. Remind people of what we economists learned in our principles courses – or at least in a principles course well-taught, such as the one that I was so very fortunate to stumble into in 1977.

I learned in ECON 101 – or, ECON 252 as Principles of Microeconomics was numbered at my undergraduate institution, Nicholls State University – that reality is *vastly* more complex than it appears to our untutored gaze or romantic imagination. I learned also the related fact that unintended consequences are commonplace. I learned that, as Thomas Sowell says, reality isn't optional; it's mandatory – and also, again as Thomas Sowell puts it, there are no 'solutions,' only trade-offs – that market signals guide us to act *as if* we have far more information than we really do or can possibly ever hope to possess.

Emphasizing these principles of economics today is especially important because today we do indeed live in a highly politicized society. In such a society, the pursuit of the personal dominates respect for principles. If some flesh-and-blood persons can be seen who would benefit – or even simply *thought* to benefit – from some course of action, politics demands pursuit of that course of action. No more justification is necessary than that these visible beneficiaries will enjoy anticipated gains.

Indeed, I think that a good definition of “a politicized society” is “a society that elevates attention to that which is seen – to that which grabs our senses and stirs our concerns *at the moment* – in disregard of principles. Insofar as society is politicized, principles and rules are cast aside if sticking to these is perceived as slowing or otherwise compromising our efforts to deal with the problems and concerns *du jour*.

Principles and rules protect and nurture that which is unseen; politics embraces only that which is seen. One consequence is that as society becomes more politicized – as society focuses ever-more intently on addressing today’s visible problems (and “problems”) with whatever means it can muster – that society serves its citizens’ long-run interests more poorly. It abandons the wisdom of principles for the wiles and wilds of pragmatism. A politicized society is in dire need of being reminded of the importance of principles.

II.

Examples of politicized pursuits today are legion, with none fitting my description better than President Biden’s executive order ‘forgiving’ up to $600 *billion* in student loans. Student-loan debt of course is burdensome to the debtors, and so *they* are of course benefitted by being relieved of the obligation to pay. That’s what is seen, and viewed in isolation it appears lovely.

But one of the greatest habits of mind of the economist is to avoid viewing economic and policy measures in isolation. The economist understands that if Jones’s debt is ‘forgiven,’ Smith or Williams – *someone* – must pay. Debt forgiveness *transfers* the burden of the debt; it doesn’t eliminate it.

The economist understands also an even deeper reality: Such debt forgiveness creates perverse incentives that, in the end, do more than merely *transfer* the burden of the debt. Such debt forgiveness makes increases the economic burden that people – especially poorer people – will bear in the future. Would-be creditors in the future become less likely to lend money. Would-be debtors in the future who could benefit from borrowing liquidity will encounter more difficulty doing so. Funds for borrowing will either be unavailable altogether or more costly to acquire. Many people who could have and would have benefitted from borrowing will be denied this benefit. But they are unseen.

The economist understands a third thing: When the benefits of some policy are concentrated on a visible group of people but the costs are dispersed over a much larger population, the persons who pay the costs might not realize – might not *see* – that they are paying. And so they don't complain. The payees, very visible, applaud and reward their benefactor. The payers, often invisible even to themselves, remain silent.

I'm no uniquely talented economist. Nor am I blessed with special insight or wisdom. Yet even as an 18-year old freshman, having just completed my first principles-of-microeconomics course, I could have explained what I as a 64-year-old full professor just explained.

This ain't, as they say, rocket science. But I submit that it's nevertheless vitally important and underappreciated. It's the kind of insight that comes from ECON 101 – from a well-taught course in economic *principles*.

The problem with our society today isn't that citizens and the elite aren't sufficiently attuned to the theoretical nuances and rococo curlicues of ECON 999; it's that citizens and the elite alike ignore ECON *101*. In fact, many *elites* insist that ECON 101 is for dummies or simpletons. They suggest that salvation lies in abandoning principles for the advanced social engineering that's too frequently implied by mastery of ECON 999.

In 2015, in a podcast with then-president of the American Enterprise Institute Arthur Brooks, the pundit Ezra Klein quipped that

> There's nothing more dangerous than somebody who's just taken their first economics class.

University of Connecticut law professor James Kwak shares Klein's contempt for economic principles. In recent years he's garnered a good deal of attention for what he called, in a 2017 piece he wrote for the *Atlantic*, "the *curse* of ECON 101."

To Klein and Kwak – and to you – I say that there are at least *two* things more dangerous than somebody who's just taken his or her first economics class. One is someone who's just completed his or her *last* economics class – ECON 999 – either having *forgotten* what was learned in ECON 101, or mistakenly 'taught' that the foundational knowledge conveyed in ECON 101 is less important than are the nuances, exceptions, and theoretical squiggles that are dominant in ECON 999.

Another, perhaps even *more* dangerous, person is someone who's never even *taken* his or her first economics class.

Let me make a bold claim: Ninety percent of all that is truly worthwhile to understand in economics is learned in a well-taught course in ECON 101. The remaining ten percent of useful economic learning comes later. But what also comes later is too often *negative* learning – learning that superficially appears to be deeper and more nuanced than economic principles but that, in fact, *rejects* economic principles and, hence, becomes dangerous. To the extent that higher-level economics courses downplay the significance of ECON 101, or portray ECON 101 merely as a starting point for mastering the more important niceties of advanced economics, higher-level economics becomes an unwitting tool for politicizing society and, in the process, abandoning principles.

III.

I mentioned earlier that among the lessons that I learned in my ECON 101 course – and that I now try to convey to my own ECON 101 students – is that economic reality is *far* more complex than it appears to our senses, and that, hence, our only source of reliable information about the myriad strangers who are connected together, and to us, in markets – and about 'objective' realities on the ground, such as relative resource scarcities – are market signals: Market prices; market wages; market-determined asset values; and market-determined profits and losses.

Economic principles tell us to respect these signals. These are the *only* sources of reliable information that we have about the economy beyond our households, clubs, churches, and neighborhoods. And of course the economy beyond our households, clubs, churches, and neighborhoods is the overwhelming bulk of the economy of which we denizens of modernity are a part.

About the vast majority of people who are affected by our actions within markets, and affected by any policies that we might pursue, we know almost nothing. We don't know the details of their situations. We don't know their preference orderings. We don't know on just what terms they would trade off one good for another good. And we surely can't begin to fathom the substantive details of the complex web of connections that ties them to us and to millions of other human beings. All that we know about them that is economically relevant is what we learn from market signals.

And so economic principles tell us that we contradict or override these signals at our – *and at their* – peril.

If we attempt to rearrange even a small part of the intricate, globe-spanning web of market connections by contradicting or overriding market signals, we have no idea of the full range of consequences we thereby unleash.

Consider, for example, the frequently heard talk of repatriating the "chains" of 'critical' supplies so that our "supply chains" are securely housed here at home. It sounds so simple! But because of what I learned in ECON 101 – and fortunately did not *un*learn in my more advanced courses – I say beware.

First is the question: *Which* supplies, exactly, are 'critical'? And *who*, exactly, will make this determination?

Perhaps an obvious answer is that the most critical of all supplies are those that sustain our lives. So at the top of the list of "critical" supplies, ahead even of medicines and military weaponry, stands food. Should government, therefore, prevent Americans from importing all foods? Well of course not; that would be silly. The importation of only *some* foods is necessary. But if only *some* foods, which ones?

A reasonable, practical person would agree: Only *some* foods are critical for our economic and military security – grains and meats, for example, but not bananas and maple syrup. Let's here simply stipulate as true that which in reality will never be true, namely, the determination of which food supplies are, and which aren't, "critical" is easily made and widely agreed upon.

But now we come to a second and far greater challenge: We must now determine which particular *inputs* are necessary for us to supply ourselves with the outputs of food that we've deemed to be "critical."

Chemical fertilizers and pesticides are necessary, of course, as are tractors and irrigation equipment. So, too, are packaging materials, delivery vehicles, fuel, and refrigeration. And don't forget insurance and financing. Without these inputs, we can neither produce enough of our critical foods nor ship what we do produce to consumers. So to "secure" our supplies of "critical" foods, government must *also* "secure" earlier links in the supply chain – namely, supplies of "critical" *inputs* to the production and distribution of "critical" foods.

But *which* inputs are "critical?" This question must be answered.

Suppose, not unreasonably, that farm tractors are declared to be among the inputs that are among the links in the "critical supply chain" for ensuring that we Americans can reliably produce our own "critical" foods. Which inputs, then, are "critical" for the production of tractors? Metals, plausibly, are critical. But is rubber? What about paint? (Unpainted farm equipment will be rapidly ruined by rust.) Which of the multitude of 'beneath-the-hood' parts of tractors – components such as fuel pumps, carbon-fiber hoses, the ceramic used in spark plugs – are "critical?"

Again, such questions about details must be answered in order to fully secure our supply 'chains' at home. Yet no person who has mastered ECON 101 can possibly believe that answering these questions is easy – or, in reality, will be done apolitically.

There's a third complexity, the biggest one of all. It's the fact that there are no supply *chains*; there's only one giant, globe-spanning supply *web*. Each output is made of inputs from many different sources, and each of those many sources supplies inputs for the production of countless other outputs. On top of this great diversity of input sources and output destinations, each input has several possible *substitutes* that will be used if the prices of these substitutes fall relative to the prices of the inputs currently being used.

This supply-web's complexity is staggering. This web works – that is, it produces something close to the 'correct' array of outputs and does so with reasonable efficiency – only because the unfathomable amount of traffic of resources travelling along its mega-gazillions of strands is guided by market signals. To override market signals in an attempt to repatriate a so-called "supply chain" is to arbitrarily pull on a visible strand so that one or two more of the nodes along that strand's length are now dragged within the country's borders.

Great! We now produce, say, our own farm-tractor tires rather than rely upon foreigners. But of course the economic consequences don't end there. The strand here being pulled is in fact connected, via other strands, to a multitude of *other* nodes. Nearly all of these strands and nodes, and their connections to each other, are unseen to the puller. No one can predict what the full consequences will be.

If government restricts American imports of farm-tractor tires, which American industries will then *shrink* as a result of foreigners having fewer dollars to buy American exports or to invest in the American economy? *Some* will, inevitably. But *which* ones specifically? *There is no way to tell*. Yet even if we *could* identify the particular American industries that would shrink, in order to determine if our 'repatriating supply chain' maneuver is worthwhile, we would then have to trace out the consequences of this shrinkage on the rest of the American economy. What will this shrinkage of other U.S. industries do to the pattern of prices of consumer goods? To the pattern of prices of inputs? *There is no way to tell*. And how will this changing pattern of prices in turn affect resource production and allocation? *There is no way to tell*.

Awareness of this unfathomable complexity is conveyed by a well-taught course in ECON 101.

IV.

The call to repatriate supply chains is an instance of the more general enthusiasm now for industrial policy. Using government to allocate resources by political or bureaucratic discretion – that is, politically – as opposed to allowing resources to be allocated by market signals, has long been popular on the political left. Such a policy, though, is now increasingly popular also on the political right.

Among the most articulate and active champions on the right for industrial policy is Oren Cass, an advisor to Mitt Romney's 2012 presidential campaign and founder of American Compass. The name of Mr. Cass's organization is revealing: He believes that the market's manner of allocating resources for investment purposes is – his term – a "drunk donkey." It meanders aimlessly if stubbornly. Industrial policy is a means of giving the market proper direction – a means of sobering the donkey up, bridling the beast, and then riding it into the economic promised land under the guidance of a map drawn up by Oren Cass.

But Mr. Cass's belief – and hubris – is easily exposed as error by a good student of ECON 101. The market does *not* meander aimlessly or stubbornly. Indeed, it doesn't meander at all. This lesson is central to ECON 101. The market is *steered* by market signals – by prices, interest rates, asset values, and profits and loses – signals that reflect information gathered and transmitted from around the globe by individuals spending and investing their own money. This lesson is central to ECON 101.

It follows that, in markets, firms profit when they please consumers at and go bankrupt when they don't. Amazon and Apple didn't, in the past few decades, spring up aimlessly; and become successful companies by pure chance. Sears and A&P didn't, a century ago, become successful companies by chance. Nor is Sears's and A&P's recent demise the result of chance. And when, as is inevitable in a market economy, Amazon and Apple eventually close up shop, *that* won't be by chance.

Competitive markets are the only real source of detailed information we have for discovering what consumers want *and* how best to meet these wants. Conveniently, competitive markets also supply to market participants appropriate incentives to heed market signals.

I needn't tell *you* that these signals are never perfect, but everyday experience tells us that they nevertheless work remarkably well, at least by any reasonable criterion.

Charlie Goetz – one of many great Virginia economists – once said that the ultimate economist's question is: Compared to what? Getting in the habit of asking this question is another lesson learned in a well-taught ECON 101 course.

And so when I hear people, Oren Cass and many others, accuse the market of 'not working,' I ask: Compared to *what*? Compared to what we can imagine being achieved by God? Yes indeed; by *this* standard the real-world market works miserably; it's a dumpster fire of failures.

Compared to perfectly competitive general equilibrium of the sort that looks so pretty in advanced textbooks and papers written by masters of ECON 999? Yes indeed; by *this* standard, too, the real-world market works poorly; it's chock-full of errors, irrationality, and other imperfections.

But – and here's another lesson from ECON 101 – unrealistic standards such as these are inappropriate. An appropriate standard of comparison is the real world *without* capitalist markets. Does any person seriously deny that those of us in capitalist economies today enjoy a material standard of living immeasurably higher than was the material standard of living of our pre-capitalist ancestors, nearly all of whom slept on dirt floors in huts with thatched rooves and no indoor plumbing? Does any person seriously deny that those of us in capitalist economies today enjoy a material standard of living far higher than was that of ordinary people in communist and socialist countries of just a few decades ago?

When I look around, I'm continually astonished at the marvels of our modern world. Supermarket shelves continue to be stocked full with goods from around the world, all affordable. Paris and New York – and Richmond – continue to be fed. Daily. We can talk in real time with people literally on the other side of the globe by pulling out from our pockets our little slabs called 'smartphones.' And if we're struck with the fancy to send to those to whom we are talking pictures of what we're eating or of our new puppy, we do that, too. It takes a matter of seconds. We drive automobiles, we fly through the air, we have Lasik surgery and antibiotics, and we live in air-conditioned homes with wi-fi and Netflix and Alexa. And all of these marvels are so routine that we don't even think about them. This regularity is itself a marvel!

I say that by any reasonable standard markets work splendidly.

Reasonable people can debate just how much of this modern market marvelousness is due to markets alone and how much is due to the support of government. But every reasonable person who is knowledgeable about economics understands that none of these market marvels would be possible without market signals.

Again, these signals are never perfect, as any good sophomore economics major can explain. But they work remarkably well. And it's a good thing that they do, because there is no other source of information on how to allocate resources. None.

From full-on socialism to industrial policy to attempts to protect so-called infant industries to proposals for ESG investing, every scheme to replace market-directed allocations of resources is a scheme that relies on nothing more than hunches. Oren Cass has a *hunch* that rearranging the U.S. economy so that more people are employed in manufacturing and fewer in finance would be a good thing. Maybe.

But he's got zero objective information on this score. And even if by some abstract calculus having more manufacturing jobs would be a good thing, neither Oren Cass nor anyone else has any idea about how to achieve this outcome at a cost that isn't excessive.

Because industrial-policy schemes ignore market signals, resources are allocated without any information on the costs of the particular allocations that are achieved. Further, because resource allocation under industrial policy is carried out by political officials rather than by the owners of the affected resources, the decision-makers have little incentive even to *care* about the costs. Whatever the costs might be, they are spread out over the entire economy, becoming invisible.

V.

Again, all of this is – or should be – ECON 101. On day one of the ECON 101 course that I teach I tell the tale of "I, Pencil." My goal is twofold. The first is the obvious one of convincing my students that the amount of knowledge used to make a simple commercial-grade pencil is so staggeringly large that no committee of geniuses could ever hope to possess more than a tiny fraction of it. I want my students to understand the pencil as a true marvel!

My second goal is to inform my students that *something* must coordinate the actions of all of the millions of producers whose efforts were necessary to make pencils a reality. That something is the market's price system. And in my principles of economics course they are introduced to the logic of how that system works.

Once this logic is understood, there is engrained a healthy skepticism of using political means to override the results of the market.

The ultimate lesson that I want to convey to my principles students is humility. I want them to appreciate just how small is the amount of knowledge any human creature can have of the enormous global economy of which we moderns are a part. I want them to know to their marrow that the economy is *vastly*, *inconceivably* more complex than it appears both to our senses and to our statistics.

They say that God made man in his own image. Not being a theologian, I can't say for sure. But I *can* say for sure that an omniscient God did *not* make man's – or woman's – *mind* in his own image. Far from it. Fortunately, however, our minds *are* capable not only of understanding the *logic* market processes, but also of appreciating their intricate beauty and complexity. This understanding and appreciation are what principles of economics are all about. Instilling this understanding and appreciation in our students, and in the public generally – along with their inevitable consequence, epistemic humility – is the greatest service that economics can perform, in both practice *and* in principle.

I encourage you to stick to your principles.

Thank you.