

“What Economics Courses Don’t Teach – But Should”

Presentation by Neva Goodwin

for the session on Education and Sustainable Development

in the conference Globalisation, New Economy and the Environment:

Business and Society Challenges for Sustainable Development

sponsored by the Russian Society for Ecological Economics

St. Petersburg, June 25, 2005

It would be tedious to start every conversation from first principles. Nevertheless, meaningful work – and a meaningful life – must be informed by an understanding of our goals. This is not often enough addressed in economics, so I will start with a very brief discussion of these basic issues.

I assume that the goals of economic theory must be closely related to the goals of the economic system. Neoclassical economic writings imply, and sometimes state, that the purpose of an economic system is to maximize the possibilities for consumption in a society. More precisely, the goal is to maximize what can be consumed that has been produced and distributed through market mechanisms.

With that assumption about the goal of the system, then the purpose of economic theory is to teach **how to achieve maximum productive efficiency, so as to maximize output, and therefore consumption, of marketed goods.**

In fact, these goals – to maximize efficiency, output, and consumption – and, by implication, wealth – are all what philosophers would call intermediate goals. They are not especially desirable for their own sake, but only valuable insofar as they support some final goal.

People may differ on the definition of final goals. Some think they can all be reduced to a single one, like service to god, or the maximization of utility. I believe that for most people there is a multiplicity of irreducible final goals. Survival is one; self-respect, or carrying out one’s responsibilities may weigh equally with some people. I find it useful to summarize a large portion of what most people seek as “ends in themselves” – final goals – by the phrase: **human well-being in the present and the future.**

As soon as we bring in the future, we bring in the issue of sustainability.

The dominant system of economics theory and education, in most parts of the world, is not contributing sufficiently to our understanding of how to achieve sustainability. It is, in fact, teaching some assumptions, values, and behaviors that work against it.

Today I will discuss some of the deep problems in neoclassical economics education, and suggest some alternatives. But first I will tell you the story of how I got involved with the teaching of economics in Russia.

In the spring of 1989, before the rest of the world knew of the changes that were about to shake the Soviet empire apart – and probably before most people here knew that such changes were imminent – the Soviet Academy of Sciences decided to dispose of all the economics textbooks then in use, and replace them with an American textbook that would be translated into Russian.

A representative of the Academy telephoned Wassily Leontief to ask his advice on which US textbook to use. He asked me to help select one. I can still remember our surprise at being confronted with this question, in the spring of 1989. I came back to Wassily with the suggestion that any existing American text would have to be substantially revised to fit the Russian context.

The result, about twelve years later, was *Mikroekonomika v kontekste*, published in Moscow in 2002 by RGGU – the Russian State University for the Humanities (Neva Goodwin, Thomas Weisskopf, Frank Ackerman and Oleg Ananyin). I and some of the original authors, with the addition of Julie Nelson, subsequently also revised the book to fit the U.S. context.

Of course, meanwhile the Soviet Academy of Sciences had ceased to exist, and with the new market system there wasn't just one, centrally-authorized economics textbook. But most of the texts in use today are much more like those used in the U.S. than like *Microeconomics in Context*. They follow what is often called the neoclassical line in economics.

I'm going to talk about some of the things that are taught in neoclassical economics which I believe to be inaccurate, and inaccurate in a manner that is damaging to the possibility of sustaining what we know as civilization, along with the natural resources on which our civilization depends.

The challenge facing teachers of economics in Russia today is to explain a market system – something that did not really exist in this country until 15 years ago, and is still not fully established with all the characteristics and institutions that such a system is supposed to have. Nevertheless, most textbooks do not try to explain Russia's actual market system, with all its flaws – any more than they try to explain the many flaws and problems of the market system existing in the U.S., or Japan, or Germany, or China.

Instead, the neoclassical paradigm describes an idealized market system, and upholds it as a goal, praising it for its qualities of **fairness** and **efficiency**.

One of the first lessons learned in standard economics courses is that competition is a good thing. It's good because it increases efficiency. Efficiency is normally just considered good in itself, but if you insist on knowing what it's good for, you will be told that it increases consumption opportunities by making it possible to obtain more output from a given level of inputs.

Other things being equal, that sounds like an excellent idea. From an environmental point of view, less materials and energy are used for a given output. From the workers' point of view, efficiency gains usually result in increased output per worker, which could result in higher wages, or shorter working hours, or both.

Of course, that doesn't always happen; in the boom years of the '90s in the U.S. labor productivity increased dramatically, but almost all of the benefits went to shareholders, in the form of profits, or to managers, in the form of soaring salaries at the top, and to consumers, enjoying lower prices. From the consumers' point of view this is what is good about efficiency – that it lowers prices.

Economists often say that efficiency is about using society's resources to maximize production of the **most valued outputs**, while using less of the more valued inputs, and more of those on which society places a lower value.

This raises the question: how are we to decide what society values most highly? Some people might think society's most valuable products include good nutrition, good education, good health, and good neighborhoods. But the market values for these things doesn't equate very well with what we might call human value. A piece of jewelry or an elaborate dacha can cost a lot more than a year's food, care, education, and housing for a child, or for many children.

You can explain this by the basic lesson from introductory economics – that prices are determined at the intersection of what suppliers can supply, under existing market circumstances, and what consumers want that they are willing and able to pay for.

Beneath this story there is, in fact, a lot of circularity; the market circumstances that affect supply are a result of prices, as well as being a partial determinant of prices. The most independent variable in this picture is on the demand side: what consumers want that they are willing **and able** to pay for. Thus the price system is ultimately a system of "one-ruble, one-vote."

So, in fact, efficiency is about producing more of the outputs that people want **and can afford to buy**; rich consumers get many more votes than poor people do. An efficient system, to put this in the crudest terms, is one that is highly responsive to the desires of the rich. If, along the way, a process uses a great deal of an input that is highly valued by many people who have few money-votes – for example, if it spoils the quality of water in a stream where poor people used to catch fish for free – that doesn't make the process inefficient, in economic terms.

By the way, I find it curious that the concept of efficiency is so rarely applied to either consumption or distribution. Might there not be important ways that well-being could be enhanced by consuming things that actually make us happy, rather than things that are designed only to make us want more? More status goods in a society do not make the whole society better off, while there are other things, such as more leisure time, good relationships, and good health that are known to contribute consistently to happiness.

Standard economic theory in the past has paid little attention to needs and wants that cannot achieve market expression through purchasing power. To some degree this oversight is beginning to be corrected with increased emphasis on externalities. The attention given to that topic may be one of the most hopeful signs that economic theory is beginning to adapt to reality.

You are all familiar with the concept of externalities – though I think many people overlook or misunderstand its potential to create common cause between environmentalists and even mainstream economists. I want to turn now to a related topic, with a possibly unfamiliar name: **meta-externalities**.

Meta-externalities are externalities in which the economic culture fouls its own nest, if the "nest" is understood broadly as all the contexts in which we humans live. In a positive development, the discipline of economics is wrestling with efforts to "internalize" the costs of economic activity that have been "externalized" to the natural world. However, other "meta-externalities" – *unwanted side-effects of the whole economic system upon its physical and social contexts* – continue to be invisible to the theory.

Critical meta-externalities show up in the impact of the economic system on the social context. A production system geared to sell luxuries creates cultures in which materialism is carried to an extreme by those who have the means to do so, and where people, seeking to “satisfy immaterial needs with material goods” are often running away from, rather than toward, their own well-being. To give some other examples, still in the realm of cultural meta-externalities:

- Productive enterprises need a workforce that has been socialized to be able to defer gratification, to think independently and sometimes creatively, and to be honest and responsible.
- Citizens and politicians need to care about the long run, and to be able and willing to address intelligently the myriad highly complex issues that face modern societies.

The sales efforts within modern enterprises are focused on a different set of requirements. From the sales point of view, the self-interest of business is served by a consumer-oriented culture of instant gratification and simplified thinking that urges material purchase as the answer to any discomfort. The strongest influence from the economy to the culture is motivated by corporations' desire to increase short-term profits and sales, achieved through advertising, ownership of news media, and purchase of political influence. Selfishness, short-term thinking, cynicism, and impatience with complexity are cultivated in the populace at large – even though these are not the characteristics that will best contribute to a healthy society or a healthy economy.

Rich nations in the world today have enough material goods and productive capacity to provide a high level of security, health, education, self-actualization, comfort, and stimulation to all of its people. They do not need to create a culture that makes people

believe – against the evidence of their senses as well as the results of good research – that happiness is usually or best achieved by “more stuff.”

The great challenge before us is how to glide off of our present path, in which whole societies are organized around the need of business to sell more things, onto a different path where business success is tied to achieving the social goal of sustainable well-being for all.

Such an idea raises a core issue, which Herman Daly has insisted on for more than forty years: **There must be some end to economic growth as we know it.**

We know that the planet cannot accommodate an indefinitely growing population or infinitely increasing consumption. And some excellent modern research at the intersection of economics and psychology shows that, after a certain, fairly modest level of comfort has been achieved, we can actually be happier, healthier, and better protect our environment by producing and consuming **less** stuff. There appears an inherent conflict between the requirements for economic health, as we know it, and an emerging vision of a better world, where people enjoy life and preserve and heal our natural environment.

Perhaps in that last sentence lies a temporary solution to the conundrum. There is much work to do in cleaning up and healing our physical environment; perhaps that could be the growth industry that would allow us to go on raising GDP through healthy activities. At least, this could help us through a transition period of a few decades, before we are forced to take an even more radical look at the future of growth.

The next set of economic beliefs to be challenged has to do with **the nature of economic activities**. Many standard textbooks state that the three significant categories of economic activity are **production, consumption** and **distribution**. This leaves out a fourth category that is equally essential: In *Economics in Context*, we call this essential economic activity **resource maintenance**.

It is well known that firms are obliged to maintain their physical capital – plant, equipment and inventory. If roads, communications systems, etc., are allowed to deteriorate, future resources will have to be diverted to rebuild what could have been maintained. The uneconomic results of degradation of the natural world – pollution, loss of species, and so on – are becoming equally obvious.

The maintenance of personal, communal and environmental, spaces for human life-support and well-being has received far less economic attention. Critical resources-maintenance activities are carried out in homes and communities, including the work that develops and maintains what may be dryly called human capital – that is, for children, nurturing, nutrition, basic education and socializing; and for those already in the work force, the refreshment of mind and body that result in enhanced health and vigor.

Ecological economists have noted the meta-externality in which the whole eco-system is endangered by the consumerist way of life, most glaringly in the fact of global warming. Socio-economists observe that critical functions of maintaining human capital may be eroded by repetitive pronouncements from the business sphere that “you deserve it all,” and “you’ve got to be the best.” Feminist economists emphasize the importance of “caring labor” for maintaining human resources. However the overall requirement for resource maintenance has not been recognized and codified in standard economic theory as one of the basic and essential economic activities.

Another broad challenge must be raised regarding the issue of **where economic activities takes place**. Much of what is economically important is not, in fact, produced, maintained, distributed, or consumed through markets. One of the critical elements missing from standard economics teachings is the importance of economic activities that take place in homes and communities. In contextual economics this is called the “core sphere” of the economy, and it is calculated to account for a minimum of 30% of economic activity in even such a highly marketized economy as the United States.

Unpaid but economically essential activities in the core economy include creating and maintaining home and other environments that support human well-being (including, e.g., the transformation of food commodities into nutrition); nurturing civic institutions; socializing children; fostering constructive norms and values; and caring for people who are not able to supply all of their own needs.

This is the system that maintains the health and sanity of workers through their productive years, and gives basic care to the infirm and the old.

If the core sphere fails in its tasks of human support, there is no viable alternative. To the extent that it fails in upholding norms of honesty, responsibility, etc., then the rest of the economy must fall back on the far less efficient alternative of policing. If governments and police are corrupt (as they are likely to be, if the people are corrupt), then efficiency very rapidly leaks out of the enforcement-dependent economy.

Mainstream textbooks focus almost solely on the business sphere of the economy, paying relatively little attention to either the core sphere or what we call the public purpose sphere. The latter comprises both government and non-profit, or NGO, activities. In the U.S. it is estimated that 59% of economic activity occurs within the business sphere, and 11% within the public purpose sphere. In a welfare state such as Sweden the public purpose sphere is at least twice as large as this, in percentage terms, and the business sphere is proportionately smaller.

The point is that production and consumption of marketed goods is a much smaller part of economic activity than you would think from the attention it receives in standard economics courses. If we want to understand the full scope of the economy we need to go well beyond the business sphere, to understand the core and public purpose spheres as well.

Indeed, economic life could continue, in a very different form, without the business sphere, but it would be much more difficult without government of some kind, and absolutely impossible without the core sphere. And all of this considers only the strictly human aspect of the economy. It is also essential to remember at all times that all three economic spheres are embedded within, and absolutely dependent upon, the natural world.

Neoclassical economics texts thus deal with a small subset of the world they should describe and explain, focusing almost exclusively on the business sphere, and there over-emphasizing the business activities that are subject to competitive market forces – a small part of the totality with which economics should be concerned.

Standard economics teaching fails to convey much of what we need to know in order to make individual, firm, government, and other decisions that will promote sustainable human well-being; and some of what it does convey actually encourages acts and decisions that work against sustainable human well-being.

I have briefly reviewed the ways in which market outcomes are determined by purchasing power, as well as by the economic power that translates into political power; the critical importance of resource maintenance; and the essential contributions of the core and public purposes spheres to economic life. All of these are issues that receive virtually no attention in mainstream economics teachings. They are among the central facts about the context for economic life that are emphasized in *Microeconomics in Context*.

A final note: you may be wondering, if *Mikroekonomika v kontekste* is such a good textbook, and was published in 2002, why haven't you heard of it? This project had the misfortune of being caught up in the fate of Mr. Khodorkovsky, who had been a major supporter of the Russian State University for the Humanities. The withdrawal of that support, and the loss of the university's rector, put things on hold, delaying publication of the teachers' manual that is designed to accompany it.

We felt with such a new approach the manual is essential to assist teachers to use the text. Happily, that is now available – it was just published this month – and *Microeconomics in Context* should be in RGGU's fall curriculum this year.

We have brought copies of the textbook and the manual to this conference, enough so that everyone here is welcome to take one copy home. If you find it of interest, it will be possible to arrange a training session in Moscow at RGGU for instructors at your university. (To make such arrangements, contact nbouis@nyc.rr.com; you may write to Nina Bouis in Russian.)