EconoFact Chats: Making Economics Instruction Relevant

Betsey Stevenson and Justin Wolfers, University of Michigan

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Michael Klein: I'm Michael Klein, executive editor of EconoFact, a nonpartisan, web based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.EconoFact.org.

The Nobel Laureate Paul Samuelson once said that "Those who will write the nation's laws if I can write its textbooks." And in fact, Samuelson did write a hugely successful textbook, which was first published in 1948. And through 19 editions has sold several million copies throughout the world. Written in the shadow of the Great Depression and the Second World War, it helped to popularize the insights of John Maynard Keynes. Of course, economic research and understanding has undergone tremendous progress since 1948. And these insights filter into subsequent generations of textbooks. One of the newest of these is by my guest on EconoFact Chats today, Betsey Stevenson and Justin Wolfers of the University of Michigan.

Betsey and Justin have many professional affiliations and experiences. I'll just mention that Betsey he served as Chief Economist at the US Department of Labor and as a member of the Council of Economic Advisors. Justin is a contributing columnist to the New York Times. Justin and Betsey, welcome to EconoFact Chats.

Justin Wolfers: It's always fun to talk economics, mate.

Michael Klein: So just so the listeners know the one with the Australian accent is Justin. You've both just written a principles of economics textbook, and that's a huge undertaking. Why did you do it?

Justin Wolfers: So you might be asking does the world need another economics textbook? And I think there's three big issues here. The first is that economics has changed. We've learned a lot over recent decades and we need to bring that into the introductory classroom. The second is that economic students have changed. Our field is no longer just the domain of upper middle class white men just before they enter a career in business. And the third is the economy has changed. This I think was obvious after the 2008-2009 financial crisis. We've also seen the economy move toward the service sector and become more weightless, the emergence of online digital commerce, and of course the pandemic economy.

And so when economics has changed, the economy has changed, economic students have changed, how we teach this material, I think has also changed.

Betsey Stevenson: A few years back Newsweek declared economics to be the sexiest trade alive. And I think that really confirmed something important has changed in economics. Recent generations of economists have brought a fresh perspective to the range of questions we ask, and refined the tools we apply. That fresh perspective has transformed the field into one that's just more useful for today's students.

Michael Klein: So Betsey, what do you mean by "useful economics?" What does that mean to you?

Betsey Stevenson: Well, economists have often liked to focus on the students who they think might grow up to run monetary policy or become economists. But the reality is that effectively none of them are going to grow up to run monetary policy. And even very few of them are going to grow up to be economists. In fact, if you're teaching a principles of economics class, you have to teach 1000 students before you find one that will likely grow up to be an economist. So we shouldn't be catering our classes to the students who are going to grow up to be economists. We should be teaching economics that's useful in the ordinary business of life, because all of our students are going to grow up to be economic actors and they're going to make really important decisions in their personal lives, in their careers, and in their community. And we can give them tools to make better decisions.

Michael Klein: I remember that in my very first economics course back in the mid 1970s, the professor said that "Most of economics can be explained by the TANSTAAFL principle." So at first I thought that was some Danish economist, but it turns out it's an acronym for, "There ain't no such thing as a free lunch." Economists typically refer to this as opportunity cost. Justin, how would you briefly explain opportunity costs to a person taking economics for the first time?

Justin Wolfers: Can I start by laughing at your professor who thinks the word TANSTAAFL is somehow more intuitive than opportunity cost?

Michael Klein: I think he just liked writing that up on the board and making us all puzzle over what it meant.

Justin Wolfers: Yeah. So look, here's the textbook definition of an opportunity cost. An opportunity cost is your next best alternative. It's what you must give up to get it. The way I like to teach in, as they say, anytime you face a decision, you always need to ask the question or what? So if your listeners simply said, "Should I listen to Michael's podcast today?" they're not going to identify the cost. But if they say, "Or what?" If it's, "Should I listen to Michael's podcast or go for a swim or spend time studying economics or spend time with my family?" Those are the alternatives that you need to give up. And so that's the cost that economists see.

Michael Klein: But in this case, in particular Justin, they should always be listening to my podcast, right?

Justin Wolfers: Well, that's when we need to get to the benefits side of the equation. And that's [inaudible].

Michael Klein: Betsey, as mentioned, you spent a lot of time working in public policy and in public service, how would the idea of opportunity costs help people understand policy decisions?

Betsey Stevenson: Just like in any decision you make, with policy decisions there's always an "Or what?" We spend a lot of resources, time, money, energy, on certain public policies. So for any policy we're pursuing, there's something we're giving up to do it. We could have used those resources for something else. This became really concrete to me when I heard people calling to defund the police. That sounds like a radical idea. And I'm not that young, So I thought it was a radical idea when I heard it. But then I realized actually what they're really doing is asking us to think about the opportunity cost of the money we spend on police departments, so that we really understand what we're giving up in order to fund those police departments. And I think we always make better policy decisions If we do ask that or what question. what else could we be doing with those resources?

Michael Klein: And Betsey, I know that in your job, like in the Department of Labor or in the Council of Economic Advisors, another issue that you had to face was what the economist called market failure. Can you just briefly describe what that means and talk about perhaps an example of that?

Betsey Stevenson: Yeah. So why do we have government in the first place? And that's because market economies work best when there's a set of rule enforcers, essentially, when we are all playing by the same set of rules. We have a lot of ways in which markets can go wrong. We've been learning about those ways over, really I think since the beginning of economics, but we've probably focused on them more over the last 50 years. And so we now know that there are things like if there's not very many employers in town, employers can have a lot of power over workers, and that can keep wages down for workers and keep money up for the owners of capital, the owners of the factories, or the businesses. So we can think about that kind of market failure.

We can also think about something like health insurance, where we all see the kinds of problems that arise there. It's not clear, if you're an insurer, you don't want to insure a lot of sick people. It's going to cost you a lot of money. You're going to have to charge really high premiums. And then people who aren't that sick don't want to buy your health insurance. So how do we make the market for health insurance work without getting government involved? Government can come in and solve some of the problems that get created when markets suffer from some of the problems economists have better understood like information problems that plague health insurance markets.

Michael Klein: Yeah. We have some good kind EconoFact memos on what you identified and economist call monopsony, only one or very few firms that hire people. And we also have them health insurance and the ways in which market failures play out there. But these things as you said, Betsey, have been long understood, and there are much more recent advances in economics that you talk about in your textbook, things like the digital economy and how economics sheds light on that. Can you talk about that a little bit?

Betsey Stevenson: Somebody once pointed out to me that most textbooks talk about the agricultural sector and manufacturing. Those are really, really small parts of our economy today. And what are the textbooks leaving out? They're leaving out what's a growing and big share of our current economy, which is the digital economy.

Justin Wolfers: Let's be clear how big, right? So the traditional goods producing sector, blokes at farms and factories are less than one fifth of the economy. What most of our students are going to go on and do is work in services.

Betsey Stevenson: So services is big, but also if you look at like the top five companies and how that's transitioning, we're seeing companies like Amazon taking over. So we need to be thinking about the ways in which the digital economy requires students to think a little bit differently, but can still use the same tools of economics. So for example, there's still a cost to using something that's free. There's also still a benefit to using something that's free. So when we think about the benefits of Google, and being able to search for things, how should we consider that? We don't pay for it or do we? We pay for it in terms of our attention, we give up attention on ads that get placed.

We can think about network effects. What digital platforms do I want to use? Well, that's going to depend on which ones my friends use. Over my lifetime social media platforms, some have succeeded and some have died. And it's all been about whether they attracted other people that attracted more people. Those are these network effects. If my friends weren't on the platform, I didn't want to be on it.

And of course over the past year with COVID, we've all learned about congestion effects, where if everybody's on Zoom at the same time, you could crash your whole household's internet because it's just too many people trying to use a small amount of bandwidth.

Michael Klein: Yeah. We have some EconoFact memos about network economies, especially as it applies to antitrust and bringing up the points that you're mentioning, Betsey. Those are by my colleagues at Tufts, Lynn Pepall and Dan Richards. So we have this new way of thinking about things that economists have developed. And as I mentioned in the introduction, Samuelson's 1948 textbook, and the subsequent editions introduce Keynesian economics to generations of students. So just like micro economics, macro economics too has undergone huge changes since then. Justin, what should the students who are just being introduced to macro economics learn so they can understand something about, for example, the economic fallout from the coronavirus pandemic?

Justin Wolfers: Well, we want them to be able to put the big picture together. That's what macro economics is. And if you think about the present moment, we're in the midst of two and a half crises. The first crisis is a supply shock, that it's the virus, the virus is out there and as a result, it's very difficult for companies to do business and their supply chain's are disrupted. There's also a demand shock. We see people are reluctant to spend money. They're uncertain. They're worried about the future. In some cases don't even want to go to the store. And then I said two and a half because the third shock, fortunately hasn't played out, or it hasn't played out yet, which is the possibility of a financial crisis. Pretty much everyone could freak out.

Michael Klein: So that term freak out. That's a technical economic term, I know.

Justin Wolfers: Exactly the right term because that's exactly what they're doing.

Michael Klein: So of course, as you well know this real attention to financial crisis spiked in, or real attention to the interplay between economics and finance, spiked in 2008 with the downturn then. And I know in your textbook you have a very innovative way of presenting the way financial markets operate and the way that the Federal Reserve interacts with financial markets that is much closer to what students were read about in newspapers than the standard old way of thinking about say the money supply. Can you talk about that a little bit, Justin?

Justin Wolfers: I think it's so important. Look, here's a effect we economists don't talk about. Many of us for many years would teach an approach to understanding the ups and downs of the business cycle. What we'd teach when we're talking to freshmen was completely different than the language that we'd go out and use when we were talking to our friends in the policy world or the media. And I think that we're at a point where we can bring the real models for understanding business cycles actually into the principles classroom.

Of course that means some simplifying. So Michael, a moment ago, we said a financial crisis is due to people freaking out. "Well, what's going on? I don't want to lend you money because I'm not sure that you'll be able to pay me back. You're not sure." And it becomes very hard for people to borrow. So one way of thinking about that is interest rates are set by two groups. The first is Jay Powell at the Fed, so that's what we call the risk-free interest rate. And then all those guys on Wall Street in their smart suits add a risk premium, call it the freakout premium. And when financial markets come under pressure, that risk premium rises, which then means the interest rate at which businesses can borrow, or you and I can borrow, rises even if the Fed does nothing.

Michael Klein: So that's an important advance because if the students are thinking about loans they want to take out or something and then they're trying to tie that into what the Federal Reserve is doing, there's this, what economists call wedge, between the interest rates they pay and what they see the Fed doing, and this is a nice way to explain it. And also then of course, we can talk more about crises where this risk premium becomes really important.

Justin Wolfers: Yeah, it's a little bit too compact and I'm sure if any of your listeners are financial specialists, they can think of more complicated ways this goes on. But really the first order effective in a financial crisis is it makes it harder for people to borrow. And then we can use the rest of the tools of economics simply to trace out what the consequences of that are going to be.

And let me add, this has been a really useful tool for understanding what would happen to the economy through the coronavirus pandemic. I found it quite easy to talk to my students about each day's news using this framework. And I claim no originality here. What I'm trying to do is teach exactly the same framework that Jay Powell is using at the Fed. Your specialist listeners will know it as the three equations new Keynesian synthesis. Of course, I didn't tell my students it's called that. But it's modern framework that we can teach in first year.

Michael Klein: Yeah. Einstein said models should be as simple as possible, but not too simple. So that's obviously one of the challenges of economics to capture the world in a simplified way, but not to assume away too much. In terms of teaching, I'd like to turn to another topic now. And I think both of you have made a very compelling case about this. My understanding of what you were trying to achieve with your textbook, and I think did achieve, is that you're trying to reach a more diverse audience. And that was one of the motivations that I think led you to write a principles of economics textbooks to begin with. So let's talk a little bit more about the issues of inequality and discrimination in our profession. And specifically the way that the teaching of economics may have excluded women or people from underserved minorities. Does economics have a discrimination problem?

Betsey Stevenson: So it's clear to me that economics has a discrimination problem. We can see that simply in the numbers. We don't have very many women or people of color at any point along the profession, we don't get them in our first year, enough of them taking first year principles courses, and we certainly don't end up with enough full professors, and we just bleed non-white men really at every margin. So let's talk about the teaching, what goes wrong? There was a really smart undergraduate student from Swarthmore who recently just had a rant about this on Twitter and-

Justin Wolfers: Not a rant. An insightful thread. And I mean it. It was a brilliant thread.

Betsey Stevenson: I mean rant in a good way.

Michael Klein: It's a good rant. Yeah.

Betsey Stevenson: Good rant.

Michael Klein: A rant against injustice.

Betsey Stevenson: Causing what John Lewis would call "good trouble." Which is she pointed out that she knew how to do the econometrics, but her econometrics problem set assumed she knew how to play golf. So she spent her time doing Google searches on golf terms so she could understand what was going on in the problem set. Another problem set assumed she knew how the mutual fund market worked. And she pointed out that this is what education scholars would call a hidden curriculum. The hidden curriculum is what we assume you know, which tells students what types of people we think belong in this classroom.

And so when we first did our labor market chapter, the labor market we used as an example was hairstylists. And a lot of male economists were like, "That's a weird example." And I was like, "Why is it a weird example? Everybody gets their hair cut."

Michael Klein: Well, wait a minute, Betsey. You know, we don't have a visual here, but those of us who are bald don't have the same experience, but go on.

Betsey Stevenson: But most of the students are not yet at that point, Michael.

Justin Wolfers: Another way of saying this is who was excluded by this example? You're saying then aging white men might not feel totally included, but my guess is that you know what a birdie and bogey are and you know something about mutual funds. So I think you're already pretty included, Michael.

Michael Klein: I actually don't play golf and I don't pay as much attention to my finances as I should. But again, point taken.

Betsey Stevenson: The point is that we do actually have to think hard about that hidden curriculum. That what education scholars tell us is that people build, the scaffolding on what they build their new knowledge is their original set of knowledge. And so if we only give examples that white men relate to, then we're making it actually harder for other people to learn. And then we're wondering why they're not learning as well, but it's actually our choice in terms of the examples.

These things do matter for people's ability to learn. I once had a textbook author who said, "It should just be about the economics. All this gender stuff doesn't matter.

That's why I only use the word he in my textbooks." It is still a choice to only refer to men in your textbooks and it's really excluding others. And it's that kind of attitude that's dominated economics for too long. And we need to make sure that we have a much more diverse set of examples. I want every single student who reads my textbook to see something that's relevant to their life, something that connects with them. I want them to be able to build on some preexisting scaffolding, no matter what kind of background they came from.

Michael Klein: And that's great because, as we've discussed, economics is really useful. The insights are very, very important. So even if these students don't go on to get masters or PhDs in economics, the fact that it's going to resonate more with them and they'll learn more, and very useful things, that's very important. So I really commend you on that. And I've been using your textbook already. I think it's just really clever and wonderful.

I also want to mention that you've just created a brand new audio course, Think Like an Economist, which is available wherever you get podcasts. And there are also supplemental material and bonus episodes on himalaya.com. So thank you both very much for joining me today on Econofact Chats. And I wish you the very best of luck with both the new podcast and your new textbook.

Justin Wolfers: Thanks so much, Michael. It's a pleasure.

Betsey Stevenson: Thank you, Michael. Really appreciate it.

Michael Klein: This has been EconoFact Chats. To learn more about EconoFact, and to see the work on our site, you can log into www.EconoFact.org. EconoFact is a publication of the Fletcher school at Tufts University. Thanks for listening.