What the heck is economics?

Louis D. Johnston  
*College of Saint Benedict/Saint John's University, ljohnston@csbsju.edu*

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What the heck is economics?

By Louis D. Johnston | 10/26/11

I visited eight sections of introductory economics this fall here at St. Ben's and St. John's. My mission: to recruit economics majors and minors. I need to do this because students have no idea what economics is or why they might want to major in the subject.

The same holds true for the general public. When I tell someone that I'm an economist, they likely say: "Oh, I took economics in college. It was so boring and it was just a bunch of equations. I didn't get anything out of it."

Sadly, research reveals that the last statement is true: Students who take introductory economics courses cannot answer basic economic questions any better other students.

I want to change that for you.

Definitions of economics

Here are two definitions of economics offered by leading economics textbooks:

"Economics is the study of how people make choices under conditions of scarcity and of the results of those choices for society." (From Robert Frank and Ben Bernanke, "Principles of Economics.")

What kinds of choices? What do we mean by scarcity? This definition doesn't seem very promising. (Ironically, I contributed to this textbook.) Let's try another:

"Economics is a way of thinking. It entails accurately describing economic events, such as the Great Depression, explaining why such events occur, predicting under what circumstances such events might take place in the future, and recommending appropriate courses of action." (From John Taylor, "Principles of Economics.")

A little better. But what is this way of thinking?

Five aphorisms

Victor Fuchs, an economist at Stanford University, wrote a wonderful book entitled "How We Live: An Economic Perspective on Americans from Birth to Death" (1983). He described the economic way of
thinking through five aphorisms. I find this to be the best way to understand the way economists think and how economics is applied to the world.

• **There is no free lunch.** Yes, you've heard this one before, but think about it again. It says that every action you might take involves a cost. Suppose, for instance, that we are considering a tax cut. This policy has a cost: the government will not earn as much revenue as it otherwise would have, meaning that government must spend less or borrow more. (No, such tax cuts do not pay for themselves, but that's another column.) Economics starts from the premise that we must set out what these alternatives are if we are to make sound choices.

• **There is more than one way to skin a cat.** (Note to my fellow cat lovers: this saying refers to catfish.) There is rarely only one way to accomplish a goal, and this maxim emphasizes this fact. For instance, we might be considering a tax cut because we want to promote faster economic growth. There are many alternative policies that can do this: increased public spending on infrastructure, changes in the regulatory environment, improvements in education are just three. This is why economists are famous for saying, "On the one hand this, on the other hand that." Our discipline is founded on the idea that there is rarely a single, optimal way to do something. And, we don't ignore these alternatives just because they might be politically unpalatable.

• **Nature doesn't make leaps.** This phrase, in Latin, is the epigram for one of the first best-selling economics textbooks: "Principles of Economics" (1890), by Alfred Marshall. (Ever notice that economists have trouble coming up with a clever new title for their books about the principles of economics?) Economists continue to embrace this notion because we have tools to find alternatives and calculate the costs of those alternatives, but these tools are not effective at measuring the effects of large, disruptive actions. For instance, economists cannot answer questions such as, "What would be the effects of eliminating taxes?" We can answer questions like, "What if taxes rates were reduced by 5 percent?" This frustrates many policy makers who prefer to ignore our economic advice.

• **There can be too much of a good thing.** One of my favorites, this adage asserts that we must compare the benefits of an action with the costs. It may have made sense to reduce tax rates in the 1980s since top tax rates were 70 percent. However, when tax rates on capital gains are 15 percent, the extra benefit of further reduction might be considerably smaller than the cost of further reduction (e.g. more borrowing).

• **Time is money.** This motto has two meanings for economists. First, it reminds us that we need to be careful to take the time value of money into consideration when we calculate costs and benefits. The ability to earn interest means that a dollar today is not worth the same as a dollar in one year. Second, it emphasizes that time is itself a resource that needs to be included in our reckoning of costs and benefits.

**Starting a conversation**
The shortest definition of economics I know of is this: "People respond to incentives. The rest is
commentary.” Economics builds on this premise to understand the world around us. I hope to use this column to help you understand economics, the economy and the economist's approach to the world.

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