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Commentary

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The 2019 Nobel Prize in Economics

The 2019 Nobel Prize in Economics has been awarded jointly to Abhijit Banerjee, Esther Duflo and Michael Kremer for their work in development economics. In the mid-1990's at Harvard University, Michael Kremer began studying the nature of poverty by the application of randomized trials, a technique that is commonly used in other fields of practical research, such as medicine, biology and chemistry. More typically, economists have historically relied on the application of theoretical models to study macroeconomic problems. However, randomized trials are now an important feature of development economics as the profession has moved away from highly theoretical models towards methods with an empirical grounding that aim to discover causal relationships in economics. At the Massachusetts Institute of Technology (MIT) Abhijit Banerjee and Esther Duflo built on the foundation of the earlier work by Michael Kremer, utilizing randomized trials to study specific areas of interest in the field of development economics, including education, healthcare, and financing for entrepreneurship. They are the joint authors of a recently published book *Good Economics for Hard Times,* in which they present a persuasive case for a policy of intelligent interventionism for society built on compassion and respect. Today's critical economic problems and challenges, such as immigration, inequality, globalization, technological disruption, slowing growth, and accelerating climate change, are sources of global anxiety that can be addressed with the appropriate methods and resources.

In announcing the award of the 2019 Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel, the Royal Swedish Academy of Sciences commented that the work of Laureates Kremer, Banerjee and Duflo, involving their experimental approach to studying problems, has considerably improved the ability to fight global poverty. One of the most important societal questions that economics can help answer is why so many people are extremely poor and what actions might be taken to alleviate poverty. The group of economists who work at the Jameel Poverty Action Lab at MIT, led by Banerjee and Duflo, has a simple radical goal; they want to overhaul development aid so that more of it is spent on programs that actually make a difference. The use of randomized trials helps to avoid the classic problem with the evaluation of aid programs, namely separating cause and effect. The Jameel Poverty Action Lab is run by Rachel Glennerster who came from the International Monetary Fund; it is attracting some of the world's best development economists, including Michael Kremer, Marianne Bertrand and Edward Miguel. Over the last couple of decades, economics has become more influential in shaping public policy. Armed with powerful new methods and tools for analyzing data, economists have addressed important real-world matters and studied the practical aspects of human behavior. Examples of this type of research include why Americans do not save enough money. Another example is discovering that modest increases in the minimum wage do not actually destroy many jobs, consequently making possible the recent state-by-state push to raise minimum wage rates. Michael Kremer is also acknowledged as an expert on theoretical aspects of economic development. His model of economic development proposes that tasks of production must be executed proficiently together in order for any of them to be of high value. His development theory explains why rich countries produce more complicated products, have larger firms and much higher worker productivity than poor countries. The model is based on assumptions that firms are risk-neutral, labor markets are competitive, workers supply labor inelastically, workers are imperfect substitutes for one another, and that there is a sufficient complementarity of tasks. Kremer derives several important conclusions from this development model: workers performing the same task earn higher wages in high-skill firms than in low-skill firms; wages will be more than proportionally higher in developed countries than would be assumed by measurements of skill levels; workers will consider human capital investments in light of similar investments by those around them; the effect of local bottlenecks reduces the expected returns to skill; and the effects across firms can create national low-production traps. This model helps explain "brain drain" and international economic disparity; if strategic complementarity is sufficiently strong, microeconomically identical nations or groups within nations could settle into equilibria with different levels of human capital.

The work of Kremer, Banerjee and Duflo represents a significant shift in emphasis from theoretical to practical economics in addressing global development issues, particularly poverty and inequality. The call to action to influence and implement public policy is not just for academic economists; it for all who seek a better, saner, more humane world with peace and justice, consistent with the United Nations Sustainable Development Goals. Economics is too important to be left to the economists.

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