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The Economics of Good and Evil

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Economics / Economic Theory

Take-Aways

- Governments should save during prosperous times to provide for the inevitable lean years. Slowing GDP growth during robust years is a wise idea.
- During the strong 2001–2008 economic cycle, people spent far more than they made.
- The "dynamic fiscal rule" states that "deficit plus GDP growth should be less or equal to a constant."
- Governments have the power to influence monetary and fiscal policy. Though politicians can't print money, they can create debt.
- When you borrow money, you are not actually richer. However, many people and governments behave as though they are.

Recommendation

As the globe recovers from an economic downturn, citizens and world leaders want economists like Tomáš Sedláček to become saviors. Instead, he holds up a mirror to their poor choices. Even those who struggle to decipher fiscal formulas and economic jargon will grasp most of Sedláček's points, which he explains through various entertaining metaphors. For that reason, *getAbstract* recommends this worthy economics lecture to laypeople and experts alike.

Summary

The bible provides what may be history's first record of a business cycle. Genesis 32 describes a pharaoh's dream in which seven fat cows precede seven lean cows. Joseph, a Hebrew prophet, interprets the dream, explaining that the pharaoh's people will enjoy seven prosperous years, then seven poor ones. The prophet recommends that during the good years, they save 20% of their output, effectively slowing GDP growth during those years, for use during the lean period. This ancient advice is sound. Alas, society largely ignores it.

> *"The economy quite often behaves like a patient with bipolar disorder."*

Indeed, fiscal policy should be contractionary in peak years and expansionary in bad years. Countries around the globe enjoyed seven good years between 2001 and 2008, but rather than following Joseph's advice, the world's citizens and governments spent far more than they made. Instead of accumulating budget surpluses and saving for lean times, they emptied the coffers and ran up enormous debt. The "dynamic fiscal rule" provides a helpful formula: "deficit plus GDP growth should be less or equal to a constant." For example, if this constant is 4, when GDP growth is 6%, the budget surpluses should be 2%, and if the economy suffers a 3% fall, the budget deficit should hover at around 7%.

> *"Government does not have the right to print money. Government still has the right to print debt."*

Governments have the authority to influence monetary policy and fiscal policy. Monetary policy includes the power to manipulate the money supply. Luckily, the ability to print money is no longer in the hands of politicians – otherwise countries would experience runaway inflation. Just as J.R.R. Tolkien's magical ring provides too great a temptation to the characters in The Lord of the Rings series, printing money is an enticement politicians can't resist. However, fiscal policy – that is, the authority to create debt – still lies within government power. The result has been an overleveraged society.

> *"Our society would not be able to function without interest rates. The way society is built today is that we need the most money in the beginning of our careers...but we have the most money at our disposal at the end of our careers."*

When you borrow money, you are borrowing against your future earnings. If you borrow $10,000, you shouldn't consider yourself $10,000 richer. However, when countries borrow money, they behave as if they are indeed wealthier. Aristotle warned against borrowing money with interest. He knew that this type of transaction was somehow bad or “spooky.” Yet borrowing money with interest is at the heart of the world’s economic policy. Borrowing at an interest rate is, in fact, similar to drinking alcohol. You may feel more energetic when you drink on a Friday night, but really you are borrowing from your “Saturday morning energy.” When you wake up the next morning, you experience the deficit: a hangover.

About the Speaker

Tomáš Sedláček lectures at Charles University in Prague, Czech Republic.

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