



This Nobel Prize Sends a Stark Signal to Columbia: Amity Shlaes

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Commentary by Amity Shlaes

Oct. 11 (Bloomberg) -- Talent gets its due, though it sometimes arrives late.

The rule holds in the case of this week's award of the Nobel Prize in economics to Edmund Phelps of Columbia University. Phelps has long sought to achieve the impossible: reconciling micro- and macroeconomics.

He has made at least two outstanding contributions. The first involves the relationship between unemployment and inflation. The second is about what makes economies grow.

In the 1960s, Phelps looked at the work of another economist, the New Zealander A.W. Phillips. Phillips had written a paper suggesting that countries must choose between two evils: inflation and unemployment. He demonstrated his concept with a graph called the Phillips Curve.

Politicians the world over soon began carrying the Phillips Curve around in their breast pockets. They loved the curve because it was like a license to fiddle: "I see that unemployment is high, so I am justified in inflating before the election."

But Phelps, along with Milton Friedman, questioned the underlying proposition, at least over the long term.

"I said, 'Where is the mechanism for this? It doesn't exist,'" he recalled in a telephone interview this week. Trained by the best Keynesians, Phelps began asking where they were going wrong.

Ignoring Phelps's query, several generations of economics professors nonetheless continued to draw the Phillips Curve on the blackboard, or, later, in PowerPoint blue. The pupils they sent to the bond market likewise traded on a Phillips basis. This meant that some were unprepared for the stagflation of the 1970s, which contradicted the Phillips trade-off directly, demonstrating that both evils -- inflation and unemployment -- can prevail simultaneously.

Second Refutation

The 1990s offered a second refutation of the Phillips Curve, with low unemployment and low inflation obtained at the same time. It is only recently that investors began talking about ignoring the curve. The Nobel committee's award acknowledges reality again: Phelps has trumped Phillips.

Phelps's other great gift has been to demystify capitalism. Many economists tend to act as though growth just happens, inevitably, like weather. Phelps, however, decided long ago that economic dynamism is not automatic, but a fragile flower.

To protect it we need to study every facet of an economy, including political institutions or culture, for example. This was a great insight, foreseeing the recent European slowdown. On paper, Europe looked ready to grow faster. But as Phelps liked to tell journalists, fuzzy factors, such as the Italian unwillingness to reproduce or the rigidity of political institutions, hold back the region.

Capitalist Tool

Phelps wanted to prevent repeat cases of Europe's malady. So a few years ago he began wandering about Manhattan trying to raise money for a center on capitalism at Columbia.

This is where another delay comes in. Given all the philanthropic dollars awash in the world, such a center sounds like a no-brainer, especially because it would be headed by a fellow who was already on the shortlist for

the Nobel Prize. New York's most-prestigious university should showcase the study of the city's proudest achievement: creating prosperity through markets.

Subset of Subset

But the cash didn't pour in, so Phelps couldn't build a giant monument. In the end, with a small amount of funding, his Center on Capitalism and Society became a subset of another, more lavish Columbia undertaking: the Earth Institute. Or to be precise, a subset of a subset of the Earth Institute. The Center on Capitalism and Society is ``a unit of the Center on Globalization and Sustainable Development at the Earth Institute at Columbia University." Even the URL, www.earth.columbia.edu/ccs, subordinates capitalism.

Jeffrey Sachs, the head of the Earth Institute, is a gracious man, and his kindness at inviting Phelps in shouldn't be discounted. Still, there is something inherently wrong with this picture.

It is capitalism of the Phelps variety that gives nations the wherewithal to fund environmental projects. The wealthier the society, the more likely it is to decide that it wants to go green. This last phenomenon is known as the Environmental Kuznets Curve, after yet another of Phelps's Nobel predecessors, Simon Kuznets. It is more logical for the Earth Institute to be a department at the Capitalism Center, rather than the other way around.

In the telephone interview, Phelps cited three areas that he said warranted further research.

Natural Place

The first was: ``Is the U.S. as dynamic as it should be?" Maybe, he said, the U.S. isn't growing as fast as it can. Among the obstacles to growth that he saw were ``archaic structures" in the corporate arena. Phelps spoke of a friend who bought a U.S. company only to find he required nine months to assemble the board for a meeting. U.S. corporate governance is too cumbersome.

The second Phelps preoccupation is the slow growth of Europe -- ``as you know, I am obsessed with the malfunctioning," he said.

Speculative markets, from foreign exchange to derivatives, are Phelps's third great interest.

Phelps was not even thinking about where such research might take place. But his own backyard of Morningside Heights seems like the natural place.

The overdue Nobel allows an outsider to point out that enlarging a center for capitalism in the capital of capitalism makes more sense than ever. Friends of Phelps or his ideas will want to help Columbia expand his center in coming years. Recognition is always sweet, but it's most useful when it comes sooner.

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