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The 2009 Nobel Prize for Economics: Reading the Tea Leaves

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by Roger Martin | Comments (1)

If you were a betting person and had a flair for the adventurous and an enthusiasm for underdogs, you could go to the racetrack and bet on a 50-1 longshot to win. But if you were really crazy, you would choose two 50-1 shots and plop your money down on the exactor (betting on the top two finishers).

And that is just what you would have had to have done to win in the Nobel Prize in Economics betting at Ladbrokes. They had 25 candidates ranging from 2-1 to 40-1 and perhaps just to satisfy the crazy betters they threw in seven 50-1 shots including Oliver Williamson and Elinor Ostrom. Fortunately for Ladbrokes, they at least had the two winners somewhere on their list, if only at the tail end.

So why did these two win the prize? Trying to figure out what motivated the Nobel Committee is a bit like Cold War Kremlinology but there are probably a few salient takeaways from this year's pick.

For starters, both were cited for their "analysis of economic governance." In the wake of the market meltdown and the general undermining of public trust in economic governance structures, it can certainly be argued that the Committee chose to be *au courant* and award two people not for being the best-economists-in-the-world-not-yet-in-possession-of-a-Nobel-prize (BEWNYPNP), but rather for having topical work.

And in fact, Ostrom is in no sense at all an economist. She is a prominent political scientist. This marks the first winner since Daniel Kahneman in 2002 to win despite being a non-economist. (Kahneman is a psychologist; I exclude from the non-economist ranks the economics-oriented mathematicians who have long been popular with the Committee). This may be yet another nod by the Committee to current events as economists are in full retreat, even having felt the need to apologize *en masse* to the Queen of England for botching their predictions leading up to the crash of 2008.

Though I am an economist by training and should probably take offense that a political scientist has crashed the Nobel's economics party, I rather like Ostrom's winning body of work (though as other economists have bravely confessed, I too had to look it up because I had never previously come across her work). She posits that just because a market is declared to have failed, we don't have to default reflexively to government regulation as the only solution. She argues that there are other institutional structures and arrangements that can produce a better result than either extreme. I like it because this is what I call *Integrative Thinking* — rather than choosing between unsatisfactory existing alternatives (i.e. free market or government regulation), put on your thinking cap and find a better solution. (I discuss this idea in more depth in my 2007 book *The Opposable Mind*).

Ostrom also reprises my personal favorite Nobel Economics winner of all time, James Buchanan (1986), who won for his work on social choice theory. Buchanan warned that when we declare a market failure because we don't like the outcome it produces, we often replace it with a regulatory ("social choice") mechanism that we don't analyze as rigorously as we analyzed the market failure. And because of the lack of critical evaluation, we get an outcome that is as bad as or worse than the market failure was in the first instance. Arguably, Ostrom provides a way of thinking through Buchanan's dilemma.

I like Williamson's work too. As with Ostrom, I see echoes of a great laureate of the past, Ronald Coase (1991). Coase helped us understand why firms exist: to reduce what would in the absence of the firm existing be painfully high contracting and transactions costs. In this way, he helped us define the boundaries of the firm. Williamson's work has built our understanding of how those boundaries work and why our firms are built to do the things they do — and not to do the things they don't.

However, I have never believed that Williamson's incremental contribution, though laudable, is great enough to warrant the Nobel with Coase already on the winners list, so he hadn't been on my own list of hopefuls. Neither was Ostrom, because she wasn't even on my radar screen. So I am glad I didn't phone up Ladbrokes and plop down a few pounds. My own favorite, especially since the Committee has loosened its criteria from pure economists, is Michael Porter. His work has profoundly influenced business and economics and I believe he is the next BEWNYPNP.

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