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AN ECONOMICS FIX

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American economists William D. Nordhaus and Paul M. Romer were jointly awarded the 50th economics Nobel prize this week in recognition of their work on economic growth and its long-run sustainability. The Nobel committee noted that the duo's work "brought us considerably closer to answering the important question of how we can achieve sustained and sustainable economic growth". The committee's praise is fitting as both economists devoted their careers to the study of the various "externalities" or "spillovers" that affect economic growth in a market economy. Mr. Nordhaus, for one, has been a pioneer in the movement towards quantifying the impact of economic growth on the climate and, in turn, the impact of climate change on economic growth. To correct this problem, he recommended imposing appropriate carbon taxes to curb pollution that was detrimental to growth in the long run. Mr. Romer, on the other hand, studied the importance of technology in achieving economic growth. He proposed the endogenous growth model where technological progress is seen as the outgrowth of businesses and other entities investing in research and development. At the same time, he recognised ways in which the market economy may undersupply technological innovations. Consequently, he recommended the use of subsidies, patents and other forms of government intervention to encourage economic growth through increased investment in technology. In essence, the Nobel committee's decision is a recognition of economic research concerning market failure.

Of course, critics have highlighted flaws in the works of these two noted economists. For one, it may often be impossible to arrive at an objective measure of the carbon tax rate or the ideal amount of pollution to allow in a developing economy. It is equally troublesome when one needs to determine how much subsidy, or other forms of government support, should be allotted towards research and development. Even though mathematical models have been devised to address these problems, they are only as good as the data fed into them. Further, such decisions regarding the perfect carbon tax rate or the ideal subsidy allocation are likely to be determined by political considerations rather than simply pure economics. So the threat of government failure may have to be taken as seriously as the effects of market failure. These concerns lead to questions about the real-world impact of the policies supported by the pair. Nonetheless, many would argue that Mr. Nordhaus and Mr. Romer's works are an improvement from the past in that they try to use the market mechanism itself to address its failures. The Nobel committee has done well to recognise important work on issues that are particularly relevant to the developing world.

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