

Title: Policy Lessons from the Economics of Ideas

Economics was once the study of scarce objects. It's conclusions, as exemplified in the writings of Thomas Malthus, were grim. Now, economists are developing an economics of ideas. Among all possible ideas, the two most important types are technologies and rules. The conclusions that emerge from the economic analysis of ideas are more optimistic. They can profoundly change our understanding of history and our vision of the future.

Malthus assumed that people don't discover new ideas. He concluded that when the number of people increases, each person has fewer objects, which leads to a lower standard of living. Ideas differ from objects because we can share them. In the world in which we actually live, one in which people can discover and share new ideas, it is better for each of us to be near to and interact with as many other people as possible. The economics of ideas can therefore explain three of the most important trends in recent history: globalization, urbanization, and growth rates that are increasing over time.

As more people interact, the rules that structure our interactions become more important and more complex. For this reason, the economics of ideas is now being extended from a narrow study of technological ideas about inanimate objects to a broader study that includes rules as a complementary class of ideas.

Historians have long understood that improvements in technologies and rules are the two drivers of human progress. Nevertheless, until the 1980s, economists had little to say about how either technologies or rules changed. They treated technological change as being "exogenous." They viewed a good system of rules as a static universal rather than a dynamic system that evolves as other parts of the economy progress. They assumed that leaders could somehow impose good rules, without explaining how actual rules changed throughout history and why rules have varied so dramatically across societies.

In the 1980s, endogenous growth theory showed that we could study the discovery and implementation of new technologies. It showed that the rules a society adopts can speed up or slow down the rate of technological change. It also showed that good rules for discovering and implementing new technologies differ in important ways from good rules for allocating scarce objects. Although strong property rights on objects are generally beneficial, strong property rights on ideas can be very harmful. This has direct implications for government policy on intellectual property rights. It also has important indirect implications for policy in such areas as education, research, and industrial competition.

The new frontier in economics is the dynamics of rules. Because they are both ideas, rules and technologies share some characteristics. Humans discover and implement new ideas of both types through a process of discovery that is guided to some extent by scientific methods, but to a very large extent by an adaptive process of experimentation. Modern corporations are like small societies with their own internal rules. We can gain important insights about the dynamics of rules by observing the dynamics of firms within an industry.

Like technologies, rules can be shared and copied. However, the dynamics of rules differs because they involve social interactions. People enforce some rules with formal incentives and punishments. They enforce other rules by instilling values about right and wrong. One of the most important practical challenges is to understand how formal incentives and punishments affect values and how values in turn affect the formal incentives and punishments.