Economics for the Citizen

by

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Economics for the Citizen - Part 1

Summary: During fall semesters, I typically teach our first-year Ph.D. microeconomics theory course. Out of a love for teaching, I've decided to not completely take off but deliver a few lectures on basic economic principles to my readership. We'll name the series "Economics for the Citizen."

Last fall semester, I didn't teach for the first time in 37 years. No, I haven't retired. It was my semester-off reward for two terms as department chairman at George Mason University. A break is well deserved after a chairmanship -- a job not unlike that of herding cats.

During fall semesters, I typically teach our first-year Ph.D. microeconomics theory course. Out of a love for teaching, I've decided to not completely take off but deliver a few lectures on basic economic principles to my readership. We'll name the series "Economics for the Citizen."

The first lesson in economic theory is that we live in a world of scarcity. Scarcity is a situation whereby human wants exceed the means to satisfy those wants. Human wants are assumed to be limitless, or at least they don't frequently reveal their bounds. People always want more of something, be it: more cars, more food, more love, more happiness, more peace, more health care, more clean air or more charity. Our ability and resources to satisfy all those wants are indeed limited. There's only a finite amount of: land, iron, workers and years in a lifetime.

Scarcity produces several economic problems: What's to be produced, who's going to get it, how's it to be produced, and when is it to be produced? For example, many Americans, and foreigners, too, would love to have a home or vacation home along the thousand miles of California, Oregon and Washington coastline. Shipping companies would like to use some of it as ports. The U.S. Defense Department would like to use it for military installations. There's simply not enough coastline to meet all the competing wants and uses. That means there's conflict over coastline ownership and its uses.

There are several methods of conflict resolution. First, there's the market mechanism -- let the highest bidder be the one who owns and decides how the land will be used. Then, there's government fiat, where the government dictates who gets to use the land for what purpose. Gifts might be the way where an owner arbitrarily chooses a recipient. Finally, violence is a way to resolve the question of who has the use rights to the coastline -- let people get weapons and physically fight it out.

At this juncture, some might piously say, "Violence is no way to resolve conflict!" The heck it isn't. The decision of who had the right to use most of the Earth's surface was settled through violence (wars). Who has the right to the income I earn is partially settled through the threats of violence. In fact, violence is such an effective means of resolving conflict that most governments want a monopoly on its use.

Which is the best method to resolve conflict issues surrounding the questions of what's to be produced, how and when it's produced, and who's going to get it? Is it the market mechanism, government fiat, gifts or violence? Before you attempt an answer -- which I'll give in the next lecture -- be advised that it's a trick question that easily traps many of my teeny-bopper sophomore students and even a few graduate students.

I personally believe that economics is fun and valuable. People who say they found it a nightmare in college just didn't have a good teacher-professor. I became a good teacher-professor as a result of tenacious mentors during my graduate study at UCLA. Professor Armen Alchian, a very distinguished economist, used to give me a hard time in class. But one day, we were having a friendly chat during our department's weekly faculty/graduate student coffee hour, and he said, "Williams, the true test of whether someone understands his subject is whether he can explain it to someone who doesn't know a darn thing about it." That's a challenge I love: making economics fun and understandable.

Economics for the Citizen - Part 2

Summary: At the end of the previous article, you were left with this question: Which is the best method of resolving conflict over what's produced, how and when it's produced, and who's going to get it? Among the methods for doing so were the market mechanism, government fiat, gifts or violence. The answer is that economic theory can't answer normative questions.

Normative questions deal with what is better or worse. No theory can answer normative questions. Try asking a physics teacher which is the better or worse state: a solid, gas, liquid or plasma state. He'll probably look at you as if you're crazy. On the other hand, if you ask your physics teacher which is the cheapest state for pounding a nail into a board, he'd probably answer that the solid state is. It's the same with economic theory, as opposed to economists. That is, if you asked most economists which method of conflict resolution produces the greater overall wealth, they'd probably answer that the market mechanism does.

The bottom line is that economic theory is "objective" or non-normative and doesn't make value judgments. Economic policy questions are normative or "subjective" and do make value judgments -- questions such as: Should we fight unemployment or inflation, should we spend more money on education, and should the capital gains tax be 15 percent or 20 percent? It's in the area of value judgments where there's so much disagreement among economists.

Keeping the distinction between non-normative and normative in mind is very important, so let me elaborate a bit. Take the statement: The dimensions of this room are 30 feet by 40 feet. That's an objective statement. Why? If there's any disagreement, there are facts to which we can appeal to settle the disagreement, namely getting out a measuring instrument. Contrast that statement with: The dimensions of this room should be 20 feet by 80 feet. Another person disagrees, saying it should be 50 feet by 50 feet. There are no facts to resolve such disagreement. Similarly, there are no facts to which we can appeal to resolve a disagreement over whether the capital gains tax should be 15 percent or 20 percent, or whether it's more important to fight inflation or unemployment.*

The importance of knowing whether a statement is non-normative or normative is that, in the former, there are facts to settle any dispute, but in the latter, there are none. It's just a matter of opinion, and one person's opinion is just as good as another. A good clue to telling whether a statement is normative is whether it contains the words should and ought.

At the beginning of each semester, I tell students that my economic theory course will deal with positive, non-normative economic theory. I also tell them that if they hear me making a normative statement without first saying, "In my opinion," they are to raise their hands and say, "Professor Williams, we didn't take this class to be indoctrinated with your personal opinions passed off as economic theory; that's academic dishonesty." I also tell them that as soon as they hear me say, "In my opinion," they can stop taking notes because my opinion is irrelevant to the subject of the class -- economic theory.

Another part of this particular lecture to my students is that by no means do I suggest that they purge their vocabulary of normative or subjective statements. Such statements are useful tools for tricking people into doing what you want them to do. You tell your father that you need a cell phone and he should buy you one. There's no evidence whatsoever that you need a cell phone. After all, George Washington managed to lead our nation to defeat Great Britain, the mightiest nation on Earth at the time, without owning a cell phone.

Our next discussion will be a bit more interesting. We'll talk about what kinds of behavior can be called economic behavior.

Economics for the Citizen - Part 3

Summary: There are four classes of behavior that can be called economic behavior. They are: production, consumption, exchange and specialization. The discussion of specialization will be left to the next article.

Production is any behavior that creates utility, that is, raises the want-satisfying capacity of something. When a mill smelts iron ore, it raises the want-satisfying capacity of the material by changing its form. The metal's want-satisfying capacity is raised further when it's made into steel and the steel into rails, girders and the like. Production also includes changing the spatial characteristics of a good. Navel oranges have no want-satisfying capacity for Philadelphians if the oranges are in California. The person sometimes called the middleman or wholesaler changes the spatial characteristics of the oranges by moving them from California to Philadelphia, thereby raising their want-satisfying capacity to Philadelphians.

Consumption is easy. Consumption is simply the reduction of the want-satisfying capacity of something. When I eat a hamburger, I reduce its want-satisfying capacity. When I drive my car, I reduce its capacity to satisfy wants. By the way, if production is greater than consumption, the result is called saving. If it's the opposite, we call it dissaving.

Exchange is a bit more complicated; misunderstanding it leads to considerable confusion and mischief. The essence of exchange is the transfer of title. Here's the essence of what happens when I buy a gallon of milk from my grocer. I tell him that I hold title to these three dollars and he holds title to the gallon of milk. Then, I offer: If you transfer your title to that gallon of milk, I will transfer title to these three dollars.

Whenever there's voluntary exchange, the only clear conclusion that a third party can make is that both parties, in their opinion, perceived themselves as better off as a result of the exchange; otherwise, they wouldn't have exchanged. I was free to keep my three dollars, and the grocer was free to keep his milk. If you think it's obvious that both parties benefit from voluntary exchange, then how come we hear pronouncements about worker exploitation?

Say you offer me a wage of $2 an hour. I'm free to either accept or reject your offer. So what can be concluded if I'm seen working for you at $2 an hour? One clear conclusion is that I must have seen myself as being better off taking your offer than my next best alternative. All other alternatives were less valuable, or else why would I have accepted the $2 offer? How appropriate is it to say that you're exploiting me when you've given me my best offer? Rather than using the term exploitation, you might say you wish I had more desirable alternatives.

While people might characterize $2 an hour as exploitation, they wouldn't say the same about $50 an hour. Therefore, for the most part, when people use the term exploitation in reference to voluntary exchange, they simply disagree with the price. If we equate price disagreement with exploitation, then exploitation is everywhere. For example, I not only disagree with my salary, I also disagree with the prices of Gulfstream private jets.

By no means do I suggest that you purge your vocabulary of the term exploitation. It's an emotionally valuable term to use to trick others, but in the process of tricking others, one need not trick himself. I'm reminded of charges of exploitation Mrs. Williams used to make early on in our 44-year marriage. She'd charge, "Walter, you're using me!" I'd respond by saying, "Honey, sure, I'm using you. If I had no use for you, I wouldn't have married you in the first place." How many of us would marry a person for whom we had no use? As a matter of fact, the problem of the lonely hearts among us is that they can't find someone to use them.

Economics for the Citizen - Part 4

Summary: In the last lecture, we discussed three of four kinds of behavior that can be called economic behavior: production, consumption and exchange. We'll turn our attention to the fourth -- specialization.

Specialization is said to occur when people produce more of a commodity than they consume or plan to consume. Specialization can occur on an individual, regional or national basis. Here are examples of each. Detroit assembly-line workers produce more crankshafts than they consume or plan to consume. Californian citrus growers produce more navel oranges than they consume or plan to consume. Brazilian coffee growers produce more coffee than they consume or plan to consume.

There are two requirements for specialization. There must be an unequal endowment of resources and trade opportunities. The unequal endowment part means that an individual has the skills or a region or nation has the kind of resource endowment of land, labor, capital and entrepreneurial talent whereby it can produce certain things more cheaply than another individual, region or nation.

For example, while it's possible to grow wheat and corn in Japan, it would be an expensive proposition. Why? Because crops like wheat and corn use a lot of land, and Japan is relatively land poor, and its land is expensive. By contrast, the United States is land rich; hence, grain production is relatively cheap. Therefore, it makes sense for the United States to take advantage of what it can do more cheaply

-- specialize in grain production -- and for Japan to specialize in what it might produce more cheaply -- say camera lenses.

In order for specialization to occur, there must be trade opportunities. It wouldn't make sense for U.S. farmers to produce more grain than they consume or plan to consume if they couldn't trade it. Neither would it make sense for Japanese producers to produce more camera lenses than they consume or plan to consume. That's why trade opportunities are necessary in order for people to take advantage of specialization.

Imagine that the Japanese government imposed trade restrictions on U.S. grain imports. Japanese farmers could charge monopoly prices and enjoy higher income, and Japanese consumers would pay higher prices. Would you deem it an intelligent response for the U.S. government to retaliate against Japan's trade restrictions by imposing trade restrictions on Japanese camera lenses, thus allowing American lens producers to charge monopoly prices and American consumers to suffer higher prices? Put another way, is it a smart response for the U.S. government to harm American consumers because Japan harmed its consumers?

Specialization and trade make people dependent upon one another for their everyday wants. How many of us make our own eyeglasses, cars, houses, clothing and food? We get all those goods by specializing in what we do well, getting paid and trading with others for what they do well. Through specialization and trade -- we might call it "outsourcing" -- we enjoy goods as if we actually produced them. By the way, those who call for independence individually, regionally or nationally are asking us to be poorer. It makes no difference whether they're calling for energy independence, clothing independence or coffee independence.

Let's look at just a few misleading statements about international trade. The United States trades with Japan. Does anyone really think that it is the members of the U.S. Congress who trade with their counterparts in the Japanese Diet? It's really individual Americans trading with individual Japanese through intermediaries.

What about fair trade? If you purchase a Japanese-made camera lens on mutually agreeable terms, you'd probably conclude that it was a fair trade, or else you would have kept your money. An American camera-lens producer might call it unfair because he couldn't sell you his lens at a higher price. Economic theory can't answer a subjective question like whether it would be fairer if you had to pay a higher price; it can say that a higher price would result your having fewer dollars for other things.

The next article will focus on one of the most important economic concepts – costs.

Economics for the Citizen - Part 5

Summary: Someone might have made you a gift of this newspaper. Does that mean reading this article is free? The answer is a big fat no. If you weren't reading the article, you might have watched television, talked to your wife or worked on your homework. The cost of having or doing something is what had to be sacrificed. While reading this article might have a zero price, it most assuredly doesn't have a zero cost.

To reinforce the idea that price is not the full measure of cost, imagine that you live in St. Louis, Mo. The barber who cuts your hair charges $20. Suppose I told you that a barber in Charleston, S.C., would charge you $5 for an identical haircut. Would you consider the Charleston haircut cheaper? While it has a lower price, it has a much greater cost. You'd have to sacrifice much more in terms of time, travel and other expenses in order to get the Charleston haircut.

People often erroneously think of costs as only material things, but that which is sacrificed when a particular choice is made can include clean air, leisure, morality, tranquility, domestic bliss, safety or any other thing of value. For example, a possible cost of a night out with the boys might be the sacrifice of domestic bliss.

Costs affect our choices in many ways, and for the purposes of this discussion, we're going to assume that all of the costs associated with a given choice are borne by the chooser.

Just about the most important generalization that we can make about human behavior is that the higher the cost of a particular choice, the less of it will be chosen, and the lower the cost, the more of it will be chosen. This generalization underlies the law of demand. For simplicity, let's assume price measures cost while we hold everything else influencing choice constant.

The law of demand can be expressed several ways: The lower the price of something, the more will be taken, and the opposite is true for the higher price. We can also say there exists a price whereby one can be induced to take more or less of something. Finally, there's an inverse (reverse) relationship between the price of a good and the quantity demanded.

Why do people behave this way? The answer, in a word or two, is that people try to be as happy as they can. For example, if when the price of oil rises, people simply ignored the price increase, they'd have less to spend on other things and be less happy. If they sought substitutes for the higher-priced oil, they'd have more money left over, and they'd be happier. That's why higher oil prices give people incentive to purchase more insulation, buy better windows, wear sweaters and maybe move to a warmer climate. These choices, and many more, are substitutes for heating oil, allowing you to use less oil.

When people say a certain amount of one thing or another is an absolute must, that's like saying the law of demand doesn't exist and there are no substitutes. That's untrue -- consider a diabetic. Can he do without 50 units of insulin a day? The law of demand says that at some price, say at $1,000 a unit, he can. There's always at least one substitute for any good, and that's doing without the good altogether. In the diabetic's case, no insulin.

While not having insulin has unpleasant consequences, it's a likely substitute at $1,000 a unit. You say, "Williams, that kind of economic analysis is cruel!" It's no crueler than the law of gravity that predicts that if you jump off a skyscraper you're going to die. Both outcomes are unattractive, but it's reality. Indeed, tragically, millions of our fellow men around the globe are forced to endure the unpleasant substitute for insulin.

In the next discussion, we'll explore some interesting features of cost, choice and the law of demand.

Economics for the Citizen - Part 6

Summary: My last article introduced the law of demand, which states, holding everything else constant, that the lower the price of something, the more people will take of it, and the higher the price, less will be taken. But there's a bit of complexity we must add. It's crucial to recognize that it's relative prices that determine choices, not absolute prices.

Relative price is one price in terms of another price. Here's an example; actually, it's a trick I pull on freshman students. I say, "Suppose your company offered to double your salary if you'd relocate to its Fairbanks, Alaska, office. Would you consider it an good deal and accept the offer?" Some students thoughtlessly answer yes. Then, I ask, "What if upon arrival you find out that rents are more than double what you're paying now and the prices of food, clothing, gasoline and other items are three and four times more expensive?" The end result is that while your absolute salary has doubled, your salary, relative to other prices, has fallen.

A bit trickier example of how it's relative prices, not absolute prices, that influence behavior comes with the observation that married couples with young children who can't be left alone tend to choose more expensive dates than married couples without children. The couple's income and tastes have little to do with their decision; it's relative prices. Keeping the numbers small, say an expensive date, dinner and concert, has a $50 price tag and a cheap date, a movie, $20. The choice of the $50 dinner-and-concert date requires that the married couple without children sacrifice two and a half movies that they could have otherwise enjoyed.

The married couple with children must pay a babysitter $10 whether they go on the expensive or cheap date. With the cost of the babysitter figured in, the dinner and concert will cost them $60 and the movie $30. In choosing the dinner-and-concert date, they sacrifice only two movies. The dinner-and-concert date is relatively cheaper for the married couple with children since they sacrifice only two movies compared to the married couple without children's two and a half. Since it's cheaper, we can expect to observe married couples with children to take more expensive dates when they go out. It doesn't take economic analysis to come up with this. A husband might suggest, "Honey, let's hire a babysitter and take in a movie." The wife replies, "That doesn't make sense. Since we have to pay $10 for a babysitter whether we go on a cheap or expensive date, why not get our money's worth and take in a dinner and concert?"

How about another example of relative prices? Suppose today's coffee price is $1 a pound, and you typically purchase two pounds per week. You hear news that a freeze in Brazil destroyed much of its coffee crop and coffee prices are expected to rise. What would you do, and why? I'm guessing you'd make larger coffee purchases now, but why? The average person would answer, to save money. That's an OK answer, but it doesn't tell the whole story. Once again, it's the law of demand working. If coffee prices are expected to rise next week, that means coffee prices this week have fallen relative to those next week, and the law of demand says that when a price of a good falls, people will take a larger quantity. It works in reverse as well. If coffee prices are expected to fall next week, you'd buy less coffee this week. Why? Coffee prices have risen this week relative to next week.

You might be tempted to ho-hum this coffee analysis as oversimplification, but it is the basic principle underlying the complexities of futures markets such as the Chicago Mercantile Exchange, where people, as speculators, become rich, sometimes poorer, guessing about the future prices of commodities.

Our next discussion will see what the law of demand says about discrimination.

Economics for the Citizen - Part 7

Summary: There's a reggae song that advises "If you want to be happy for the rest of your life, never make a pretty woman your wife." Mechanics have been accused of charging women higher prices for emergency road repairs. Airlines charge business travelers higher prices than tourists. Car rental companies and hotels often charge cheaper rates on weekends. Transportation companies often give senior citizen and student discounts. Prostitutes charge servicemen higher prices than their indigenous clientele. Gasoline stations on interstate highways charge higher prices than those off the interstate. What are we to make of all of this discrimination? Should somebody notify the U.S. attorney general?

The fact that sellers charge people different prices for what often appear to be similar products is related to a concept known as elasticity of demand, but we won't get bogged down with economic jargon. Think about substitutes. Take the reggae song's advice about not taking a pretty woman as a wife. Pretty women are desired and sought after by many men. An attractive woman has many substitutes for you, and as such, she can place many demands on you. A homely woman has far fewer substitutes for you and cannot easily replace you. Hence, she might be nicer to you, making what economists call "compensating differences."

It's all a matter of substitutes for the good or service in question. Business travelers have less flexibility in their air-travel choices than tourists. Women generally see themselves as having fewer alternatives for emergency auto repairs. A man might have more knowledge about making the repair or be more willing to risk hitchhiking or walking. A prostitute might see a sailor on shore leave as having fewer substitutes for her services than the area's residents. Motorists traveling from city to city are less likely to have information about cheaper choices than local residents.

Politicians seem to ignore the fact that when the price of something changes people respond by seeking cheaper substitutes. New York City raised cigarette taxes, thereby making a pack of cigarettes $7. What happened? A flourishing cigarette black market emerged.

In 1990, when Congress imposed a luxury tax on yachts, private airplanes and expensive automobiles, Sen. Ted Kennedy and then-Senate Majority Leader George Mitchell crowed publicly about how the rich would finally be paying their fair share of taxes. But yacht retailers reported a 77 percent drop in sales, and boat builders laid off an estimated 25,000 workers. What happened? Kennedy and Mitchell simply assumed that the rich would behave the same way after the imposition of the luxury tax as they did before and the only difference would be more money in the government's coffers. They had a zero-elasticity vision of the world, namely that people do not respond to price changes. People always respond, and the only debatable issue is how much and over what period.

This elasticity concept is not restricted to what are generally seen as economic matters; it applies to virtually all human behavior. When a parent asks his child, "How many privileges must I take from you to get you to behave?" that's really an elasticity question. In other words, how high must the punishment price be for the misbehavior in order to get the child to take less of it? It's easy to see how elasticity applies to law enforcement as well. What must be done to the certainty of prosecution and punishment to get criminals to commit less crime?

My next article will focus on property rights, a non-economic concept that has a heavy impact on economics.

Economics for the Citizen - Part 8

Summary: Economic theory is broadly applicable. However, a society's property-rights structure influences how the theory will manifest itself. It's the same with the theory of gravity. While it, too, is broadly applicable, attaching a parachute to a falling object affects how the law of gravity manifests itself. The parachute doesn't nullify the law of gravity. Likewise, the property-rights structure doesn't nullify the laws of demand and supply.

Property rights refer to who has exclusive authority to determine how a resource is used. Property rights are said to be communal when government owns and determines the use of a resource. Property rights are private when it's an individual who owns and has the exclusive right to determine the non-prohibited uses of a resource and receive the benefit therefrom. Additionally, private-property rights confer upon the owner the right to keep, acquire and sell the property to others on mutually agreeable terms.

Property rights might be well defined or ill defined. They might be cheaply enforceable or costly to enforce. These and other factors play a significant role in the outcomes we observe. Let's look at a few of them.

A homeowner has a greater stake in the house's future value than a renter. Even though he won't be around 50 or 100 years from now, the house's future housing services figure into its current selling price. Thus, homeowners tend to have a greater concern for the care and maintenance of a house than a renter. One of the ways homeowners get renters to share some of the interests of owners is to require security deposits.

Here's a property-rights test question. Which economic entity is more likely to pay greater attention to wishes of its clientele and seek the most efficient methods of production? Is it an entity whose decision makers are allowed to keep for themselves the monetary gain from pleasing clientele and seeking efficient production methods, or is it entities whose decision makers have no claim on those monetary rewards? If you said it is the former, a for-profit entity, go to the head of the class.

While there are systemic differences between for-profit and non-profit entities, decision makers in both try to maximize returns. A decision maker for a non-profit will more likely seek in-kind gains such as plush carpets, leisurely work hours, long vacations and clientele favoritism. Why? Unlike his for-profit counterpart, he doesn't have property rights to take his gains. Also, since he can't capture for himself the gains and doesn't himself suffer the losses, there's reduced pressure to please clientele and seek least-cost production methods.

You say, "Professor Williams, for-profit entities sometimes have plush carpets, have juicy expense accounts and behave in ways not unlike non-profits." You're right, and again, it's a property-rights issue. Taxes change the property-rights structure of earnings. If there's a tax on profits, then taking profits in a money form becomes more costly. It becomes relatively less costly to take some of the gains in non-money forms.

It's not just businessmen who behave this way. Say you're on a business trip. Under which scenario would you more likely stay at a $50-a-night hotel and eat at Burger King? The first is where your employer gives you $1,000 and tells you to keep what's left over. The second is where he tells you to turn in an itemized list of your expenses and he'll reimburse you. In the first case, you capture for yourself the gains from finding the cheapest way of conducting the trip, and in the second, you don't.

These examples are merely the tip of the effect that property-rights structure has on resource allocation. It's one of the most important topics in the relatively new discipline of law and economics.

Economics for the Citizen - Part 9

Summary: We're all grossly ignorant about most things that we use and encounter in our daily lives, but each of us is knowledgeable about tiny, relatively inconsequential things.

For example, a baker might be the best baker in town, but he's grossly ignorant about virtually all the inputs that allow him to be the best baker. What is he likely to know about what goes into the processing of the natural gas that fuels his oven? For that matter, what does he know about oven manufacture? Then, there are all the ingredients he uses -- flour, sugar, yeast, vanilla and milk. Is he likely to know how to grow wheat and sugar and how to protect the crop from diseases and pests? What is he likely to know about vanilla extraction and yeast production? Just as important is the question of how all the people who produce and deliver all these items know what he needs and when he needs them. There are literally millions of people cooperating with one another to ensure that the baker has all the necessary inputs.

It's the miracle of the market and prices that gets the job done so efficiently. What's called the market is simply a collection of millions upon millions of independent decision makers not only in America but around the world. Who or what coordinates the activities all of these people? Rest assuredly it's not a bakery czar.

There are a number of ways to allocate goods and services. They include: first-come-first-served, gifts, violence, dictatorship or lotteries. When the price mechanism performs the allocation function, we realize efficiency gains absent in other methods. The price mechanism serves as a signaling function. Prices rise and fall, reflecting scarcities and surpluses. When prices rise as a result of higher demand, this acts as a signal to suppliers to expand output. They do so because whenever the price exceeds the costs of production, they stand to gain. They ship the goods to those with the highest willingness to pay.

Let's look at just one of the baker's needs -- flour. How does the wheat farmer know whether there's a surge in demand for bakery products? The short answer is that he doesn't. All he knows is that millers are willing to pay higher wheat prices, so he's willing to put more land under cultivation or reduce his wheat inventory. In other words, prices serve the crucial role of conveying information. Moreover, prices minimize the amount of information that any particular player involved in the process of getting flour to the baker needs in order to cooperate.

What if politicians thought that flour prices were too high and enacted flour price controls in the wake of a surge in demand for bakery products? Would wheat farmers put more land under cultivation? Would millers work overtime to produce more flour? The answer is a big fat no because what would be in it for them? The result would be flour shortages, but the story doesn't stop there because mankind is ingenious about getting around government interference. If there were flour price controls, we'd see black markets emerging -- people buying and selling flour at illegal prices. That's always one effect of price controls. Another would be the corruption of public officials who know about the illegal activity but for a price look the other way.

In 302, the Roman emperor Diocletian commanded "there should be cheapness," declaring, "Unprincipled greed appears wherever our armies ... march. ... Our law shall fix a measure and a limit to this greed." The predictable result of Diocletian's food price controls were black markets, hunger and food confiscation by his soldiers. Despite the disastrous history of price controls, politicians never manage to resist tampering with prices -- that's not a flattering observation of their learning abilities.

Economics for the Citizen - Part 10

Summary: In 10 short articles, there's no way to even scratch the surface of economic knowledge. I'll simply end the series with a discussion of a few popular sentiments that have high emotional worth but make little economic sense. I use some of these sentiments as a teaching device in my undergraduate classes.

Here's one that has considerable popular appeal: "It's wrong to profit from the misfortune of others." I ask my students whether they'd support a law against doing so. But I caution them with some examples. An orthopedist profits from your misfortune of having broken your leg skiing. When there's news of a pending ice storm, I doubt whether it saddens the hearts of those in the collision repair business. I also tell my students that I profit from their misfortune -- their ignorance of economic theory.

Then, there's the claim that this or that price is unreasonable. I used to have conversations about this claim with Mrs. Williams early on in our 44-year marriage. She'd return from shopping complaining that stores were charging unreasonable prices. Having aired her complaints, she'd ask me to go out and unload a car trunk loaded with groceries and other items. Having completed the chore, I'd resume our conversation, saying, "Honey, I thought you said the prices were unreasonable. Are you an unreasonable person? Only an unreasonable person would pay unreasonable prices."

The long and short of it is that the conversation never went over well, and we both ceased discussions of reasonable or unreasonable prices. The point is that whatever price a transaction is transacted at represents a meeting of the mind of both buyer and seller. Both viewed themselves as being better off than the next alternative -- not making the transaction. That's not to say that the seller wouldn't have found a higher price more pleasing or the buyer wouldn't have been pleased with a lower price.

How about your parents' admonition that "Whatever's worth doing is worth doing as well as possible"? That's not a wise admonition. I tell my students, often to their amazement, that it might not be worth it to try to get the best grade possible in economics. Let's look at it. Say they have biology, physics, English and economics classes. They work their butts off in economics, earning an A, but spending so much time studying economics takes time away from other classes, and they wind up earning an F in biology, a C in physics and a D in English. That makes for a semester grade point average of 1.75. They'd be better off, in terms of grade point average, if they spent less time studying economics, maybe earning a C, and allocating more time to biology and English and thereby earning a C grade in all their subjects. They'd have a higher grade point average (2.0) and wouldn't be on academic probation.

Another example: You ask your wife to have the house as neat and clean as possible when you return from work. You return, and the house is immaculate. You compliment her, saying, "That's a great job, honey. What's for dinner, and where are the kids?" She responds, "I don't know where the kids are, and there's no dinner prepared, but the house is immaculate." Just as getting the best economics grade possible is non-optimal, so is doing the best job possible cleaning the house.

Then, there's "You can never be too safe." Yes, you can. How many of us bother to inspect the hydraulic brake lines in our cars before we start the engine and head off to work? Doing so would be safer than simply assuming that the lines were intact and driving off. After all, prior to launching a space vehicle, the people at NASA make no similar assumptions. They go through a countdown of all systems, taking nothing for granted. Erring on the side of over-caution is costly, and so is erring on the side of under-caution, though for a given choice, one might be costlier than the other.