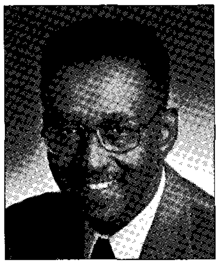
# Economics for the Citizen: Part V



BY WALTER E. WILLIAMS

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 the metallurgy involved in 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 how do 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 anonymously 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 assured it's not a bakery czar.

There are a number of ways to allocate goods and services—deciding the who, what, how, and when of production and consumption. They include: first-come-first-served, gifts, violence, dictatorship, or lotteries. When it's the price mechanism that 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 agent 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 decreed "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.

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## Little Economic Sense

In five short articles there's no way to even scratch the surface of economic knowledge. I'll simply end the series highlighting a few popular sentiments that have high emotional worth but make little economic sense. I use some of these sentiments as a teaching tool 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 46-year marriage. She'd return from shopping complaining that stores were charging unreasonable prices. She'd then ask me unload a car trunk full of 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 at whatever price a transaction is made, it represents a meeting of the minds of both buyer and seller. Both viewed themselves as being better off than with 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 wanted a lower price.

## Parents' Admonition

How about your parents' admonition that "Whatever's worth doing is worth doing as well as possible"? Taken at face value, that's not a wise admonition. I tell my students, often to their surprise, 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, 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.

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 taking for granted that the lines were intact and driving off. After all, prior to launching a space vehicle, the people at NASA make no similar mechanical assumptions. They go through extensive multiple checks of all systems, taking nothing for granted. Erring on the side of overcaution is costly, and so is erring on the side of undercaution, though for a given choice, one might be costlier than the other.



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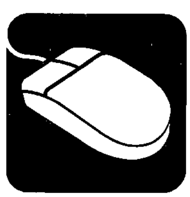

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"The greatest tyranny has the smallest beginnings. From precedents overlooked, from remonstrances despised, from grievances treated with ridicule, from powerless men oppressed with impunity and overbearing men tolerated with complacence, springs the tyrannical usage which generations of wise and good men may hereafter perceive and lament and resist in vain."

— An 1846 editorial, *The London Times*


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