WHAT IS ECONOMICS?

Whether one is a conservative or a radical, a protectionist or a free trader, a cosmopolitan or a nationalist, a churchman or a heathen, it is useful to know the causes and consequences of economic phenomena.

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Understanding most of the economic issues discussed in the media and in politics requires knowledge of only the most basic principles of economics—and yet these principles are unknown to most of the public, and are widely ignored by politicians and journalists, and even by many scholars outside the field of economics.

Principles of economics apply around the world and have applied over thousands of years of recorded history. They apply in many very different kinds of economies—capitalist, socialist, feudal, or whatever—and among a wide variety of peoples, cultures, and governments. Policies which led to rising price levels under Alexander the Great have led to rising price levels in America, thousands of years later. Rent control laws have led to a very similar set of consequences in Cairo, Hong Kong, Stockholm, Melbourne, and New York. So have similar agricultural policies in India and in the European Union countries.

Differences in economic practices from one country to another are also revealing. There were economic reasons why manufacturing enterprises in the days of the Soviet Union kept almost enough inventory on hand to last a year, while inventories of supplies in some Japanese companies like Toyota are only enough to last a matter of hours, with new pans and equipment arriving at the factory at various times during the day, to be unloaded from trucks and installed immediately on cars as they are being assembled. Both very different inventory policies had a rational basis, given the very different kinds of economic systems in which they existed.

Economics is more than just a way to see patterns or to unravel puzzling anomalies. Its fundamental concern is with the material standard of living of society as a whole and how that is affected by decisions made by individuals and institutions. One of the ways of doing this is to look at economic policies and economic systems in terms of the incentives they create, rather than simply the goals they pursue. This means that consequences matter more than intentions—and not just the immediate consequences, but also the longer run repercussions of decisions, policies, and institutions.

Nothing is easier than to have good intentions but, without an understanding of how an economy works, good intentions can lead to disastrous consequences for a whole nation. Many, if not most, economic disasters have been a result of policies intended to be beneficial—and these disasters could often have been prevented if those who originated and supported such policies had understood economics.

Mary people agree on the importance of economics, but there is much less agreement on just what economics is. Among the misconceptions of economics is that it is something that tells you how to make money or run a business or predict the ups and downs of the stock market But economics is not personal finance or business administration, and predicting the ups and downs of the stock market has yet to be reduced to a dependable formula.

To know what economics is, we must first know what an economy is. Perhaps most of us think of an economy as a system for the production and distribution of the goods and services we use in everyday life. That is true as for as it goes, but it does not go far enough. The Garden of Eden was a system for the production and distribution of goods and services, but it was not an economy, because everything was available in unlimited abundance. Without scarcity, there is no need to economize—and therefore no economics. A distinguished British economist named Lionel Robbins gave the classic definition of economics:

Economics is the study of the use of scarce resources which have alternative uses.

In other words, economics studies the consequences of decisions that are made about the use of land, labor, capital and other resources that go into producing the volume of output which determines a country's standard of living. Those decisions and their consequences can be more important than die resources themselves, for there are poor countries with rich natural resources and countries like Japan and Switzerland with relatively few natural resources but high standards of living. The values of natural resources per capita in Uruguay and Venezuela are several times what they are in Japan and Switzerland, but income per capita in Japan and Switzerland is about double that of Uruguay and several times that of Venezuela.

The decisions that influence such outcomes are not only the decisions of individuals, or industrial or agricultural enterprises, or the policies of governments. Among the major decisions affecting economic outcomes are decisions about what kinds of enduring institutions a society has for making those decisions—what kind of economic system, operating within what kind of legal system, and controlled by what kind of political system. In analyzing all these decisions and examining the evidence of their consequences, it is crucial to keep in mind at all times that the resources being used are both scarce and have alternative uses. When a politician promises that his policies will increase the supply of some desirable goods or services, the question to be asked is: At the cost of less of what other goods and services?

What does ''scarce'' mean? It means that what everybody wants adds up to more than there is. What this implies is that there are no easy "win-win" so-lutions but only serious and sometimes painful trade-offs. This may seem like a simple thing, but its implications are often grossly misunderstood, even by highly educated people. For example, a feature article in the New York Times laid out the economic woes and worries of middle-class Americans—one of the most affluent groups of human beings ever to inhabit this planet. Although this story included a picture of a middle-class American family in their own swimming pool, the main headline read: "The American Middle, Just Getting By." Other headings in the article included:

- Wishes Deferred and Plans Unmet
- Goals That Remain Just Out of Sight
- Dogged Saving and Some Luxuries

In short, middle-class Americans' desires exceed what they can comfortably afford, even though what they already have would be considered unbelievable prosperity by people in many other countries around the world—or even by earlier generations of Americans. Yet both they and the reporter regarded them as "just getting by" and a Harvard sociologist was quoted as saying "how budget-constrained these people really are." But it is not something as manmade as a budget which constrains them: Reality constrains them. There has never been enough to satisfy everyone completely. That is the real constraint. That is what scarcity means.

Although per capita real income in the United States increased 51 percent in just one generation, these middle-class families "have had to work hard for their modest gains" according to a Fordham University professor quoted in the same article. However, it is doubtful whether most other people in the world would regard Americans' work in air-conditioned offices with coffee breaks as "hard” or their standard of living as “just getting by.” Still, the situation seemed to be viewed as not wholly satisfactory, and perhaps even puzzling, by the people themselves.

The New York Times reported that one of these middle-class families “got in over their heads in credit card spending" but then "got their finances in order."

"But if we make a wrong move," Geraldine Frazier said, "the pressure we had from the bills will come back, and that is painful.”

To all these people—from academia and journalism, as well as the middle-class people themselves—it apparently seemed strange somehow that there should be such a thing as scarcity and that this should imply a need for both productive efforts on their part and personal responsibility in spending. Yet nothing has been more pervasive in the history of the human race than scarcity and all the requirements for economizing that go with scarcity.

Regardless of our policies, practices, or institutions—whether they are wise or unwise, noble or ignoble—there is simply not enough to go around to satisfy all our desires to the fullest. "Unmet needs” are inherent in these circumstances, whether we have a capitalist, socialist, feudal, or other kind of economy. These various kinds of economies are just different institutional ways of making trade-offs that are inescapable in any economy.

Economics is not just about dealing with the existing output of goods and services as consumers. It is also, and more fundamentally, about producing that output from scarce resources in the first place—turning inputs into output. Not only scarcity but also "alternative uses” are at the heart of economics. If each resource had only one use, economics would be much simpler. But water can be used to produce ice or steam by itself or innumerable mixtures and compounds in combination with other things. Nitroglycerine is a powerful explosive, but it is also used medically to ease chest pains. Similarly, from petroleum comes not only gasoline, kerosene, and fuel oil, but also plastics and Vaseline. Iron ore can be used to produce steel products ranging from paper clips to automobiles to the frameworks of skyscrapers.

How much of each resource should be allocated to each of its many uses? Every economy has to answer that question, and each one does, in one way or another, efficiently or inefficiently. Doing so efficiently is what economics is all about Different kinds of economies are essentially different ways of making decisions about the allocation of scarce resources—and those decisions have repercussions on the life of the whole society. During the days of the Soviet Union, for example, that country's industries used more electricity than American industries used, even though Soviet industries produced a smaller amount of output than American industries produced. More steel, cement, and other resources used for producing a given output likewise resulted in less output in the Soviet Union than in countries such as Japan or Germany. Such inefficiencies in turning inputs into outputs translated into a lower standard of living, in a country richly endowed with natural resources—perhaps more richly endowed than any other country in the world. Russia is, for example, one of the few industrial nations that produces more oil than it consumes. But an abundance of resources does not automatically create an abundance of goods.

In early twenty-first century China, seven times as much energy has been used to produce a given value of output as Japan uses to produce that same value of output Here again, huge differences in efficiency have meant huge differences in standards of living for millions of human beings. Efficiency in production—the rate at which inputs are turned into output—is not just some technicality that economists talk about It affects the life of whole societies. When visualizing this process, it helps to think of the real things—the iron ore, petroleum, wood and other inputs that go into the production process and the food, furniture, and automobiles that come out the other end—rather than think of economic decisions as being simply decisions about money.

Although the word “economics" suggests money to some people, for a society as a whole money is just an artificial device to get real things done. Otherwise, the government could make us all rich by simply printing more money. It is not money but the volume of goods and services which determines whether a country is poverty stricken or prosperous.

Economics is not about the financial fate of particular individuals or particular enterprises. It is about the material well-being of society as a whole. When economists analyze prices, wages, profits, or the international balance of trade, for example, it is from the standpoint of how decisions in various parts of the economy affect the allocation of scarce resources in a way that raises or lowers the material standard of living of the people as a whole.

Economics is not simply a topic on which to express opinions or vent emotions. It is a systematic study of what happens when you do specific things in specific ways. In economic analysis, the methods used by a Marxist economist like Oskar Lange did not differ in any fundamental way from the methods used by a conservative economist like Milton Friedman. It is these basic economic principles that this book is about.

While there are controversies in economics, as there are in science, this does not mean that the basic principles of economics are just a matter of opinion, any more than the basic principles of chemistry or physics are just a matter of opinion. Einstein's analysis of physics, for example, was not just Einstein's opinion, as the world discovered at Hiroshima and Nagasaki. Economic reactions may not be as spectacular or as tragic, as of a given day, but the worldwide depression of the 1930s plunged millions of people into poverty, even in the richest countries, producing malnutrition in countries with surplus food, probably causing more deaths around the world than those at Hiroshima and Nagasaki. Conversely, when India and China—historically, two of the poorest nations on earth—began in the late twentieth century to make fundamental changes in their economic policies, their economies began growing dramatically. It has been estimated that 20 million people in India rose out of destitution in a decade. In China, the number of people living on a dollar a day or less fell from 374 million—one third of the country's population in 1990—to 128 million by 2004, now just 10 percent of a growing population. In other words, nearly a quarter of a billion Chinese were now better off as a result of a change in economic policy.

Things like this are what make the study of economics important—and not just a matter of opinions or emotions. Economics is a tool of analysis and a body of tested knowledge—and of principles derived from that knowledge.

Money doesn't even have to be involved to make a decision be economic. When a military medical team arrives on a battlefield where soldiers have a variety of wounds, they are confronted with the classic economic problem of allocating scarce resources which have alternative uses. Almost never are there enough doctors, nurses, or paramedics to go around, nor enough medications. Some of the wounded are near death and have little chance of being saved, while others have a fighting chance if they get immediate care, and still others are only slightly wounded and will probably recover whether they get immediate medical attention or not.

If the medical team does not allocate its time and medications efficiently, some wounded soldiers will die needlessly, while time is being spent attending to others not as urgently in need of care or still others whose wounds are so devastating that they will probably die in spite of anything that can be done for them. It is an economic problem, though not a dime changes hands.

Most of us hate even to think of having to make such choices. Indeed, as we have already seen, some middle-class Americans are distressed at having to make much milder choices and trade-offs. But life does not ask us what we want It presents us with options. Economics is one of the ways of trying to make the most of those options.