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Excerpt
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INTRODUCTION

What comes to mind when you think about economics? Nothing good, if you are the reader I most want to reach. You know little or nothing of it and have always found it forbidding. Even if you took an introduction to economics in college (perhaps at your father's insistence), you remember little of it. The class was boring. Depending on your age, you were presented with screechy blackboards with chalk dust flying or whiteboards or slides with diagram after diagram. Your professor, whether droning or excited, would have been telling you that diagrams were the best way to really understand economics.

He was wrong. That is not the best way for you to understand economics. Yet, who am I to make such a declaration? The book jacket says I'm a political scientist, not even an economist.

Early in graduate school at Cornell, I took over 20 hours of coursework in economics. Later, as a professor of politics at the University of Virginia (UVA), I was told that I would be teaching basic economics to graduate students in public administration. As is sometimes the case, UVA's master's program was housed in our politics department. So, I had to think about what, in one semester, future public administrators who knew little or nothing about economics needed to know.

No economics textbook was satisfactory. All those diagrams! What had gotten me excited about economics were wonderful concepts such as opportunity cost and marginalism, which were used to illuminate political issues through cases, examples, and anecdotes. I decided to write my own book.

Absorbing the essence of economics need not be bitter medicine. I think I can make it more interesting and illuminating than you thought economics could be. A George Mason University economist, who previously taught at the University of Virginia, introduced my talk at GMU by saying that "one of my UVA students completing the major told me 'the only economics I remember is what I learned from Rhoads.'"

The editor of *The Concise Encyclopedia of Economics* apparently thought I explained an important concept, marginalism, better than any of his economist peers. He lifted most of the entry on marginalism from a chapter in my 1985 book.[1] He has also written online that he considers the first edition of this book to be one of the ten best books written in economics in the last 50 years. In his review of the first edition, John Brandl, the economist who was the founding dean of the Hubert H. Humphrey School of Public Affairs at the University of Minnesota, called the book "marvelous… Reading it, an economist is taken aback that a person outside the discipline could understand it so thoroughly; and then, precisely because he is not *of* economics, offer new insights into its applicability, and provide a biting critique of its limitations."[2]

There are many books about economics written by distinguished economists. I want you to believe that the best person to teach you about the economist's view of the world may not even have a formal credential in the discipline. No matter who you read, there can be no doubt that some knowledge of economics is essential to good citizenship in a modern democracy. Next to law, it is also the most politically influential subject in a modern university.

If you decide to let me talk to you about economics, you will find that I have a lot of good things to say about markets. Praising markets sounds like something that conservatives do. But, in fact, almost all economists love markets. For example, the politics of Nobel laureate Joseph Stiglitz are well to the left of most economists. He favors many things Bernie Sanders and Alexandria Ocasio-Cortez favor. He thinks our current economic system is not "efficient, stable or fair." But he refuses to join a democratic socialism movement; he prefers the term "progressive capitalism," because it "emphasizes that markets with private enterprise are at the core of any successful economy."[3]

Markets give information to the people who need it and will act on it without flooding "in-boxes." And flood them they will if you try to run an economy without using a market. After all, without a market, how would we decide who should get the sawdust?

Sawdust? Yes, sawdust. In 2008 the price of milk was much higher than usual. An economist asked a dairy farmer, how come?[4] The farmer said his inputs were much more expensive. For example, the price of sawdust had doubled within a year. (Within two years it had gone up by a factor of four for some uses.) He used sawdust to bed his cows more comfortably. They produced more milk when they were more often off their feet. The reason for the increase in the price of sawdust was the sharp downturn in the production of new housing. Since construction of new houses was down, there was less sawdust.

So, imagine you are a politician or a planner trying to satisfy citizens complaining about the high price of milk. Suppose you decide that you could please these citizens by reducing the price of milk in school cafeterias. But another problem citizens were complaining about was homelessness and the high price of affordable housing. Would you realize that using more sawdust to produce milk would increase the price of housing? Probably not. But it would increase housing costs, because sawdust is also the principal component in particleboard, which is used widely in the building industry. It is cheaper than substitutes such as lumber and plywood. You probably wouldn't know that.

Many of your constituents also love gardening, and they would not be happy if the sawdust they use to make their mulch became more expensive because some of it was being siphoned off to help "higher-priority" users. Sawdust is also used in the production of charcoal briquettes and as part of a mix to make a lightweight material for dashboards. It would take a planner a lot of time to decide on the fair and efficient allocation of sawdust. No matter what he decided, many people would think his decision was unfair.[5]

Of course, no politician or planner would have time to worry about sawdust. If there were no entrepreneurs or markets, sawdust would probably be thrown away or used only for mulch; no one would know that the waste product had these other uses. Even if they eventually figured it out, how would they decide which usage was the most important and how much should go to it and how much for the second most important usage?

The lowly sawdust example shows that there is a "dense interconnection" of different kinds of scarce resources.[6] No planner could sort everything out efficiently. This is an important reason why we need markets. If doing something to reduce the high price of milk was so complicated, imagine if you had to plan for a whole economy.

The communist regimes of the twentieth century did not use markets and had poor economic performance. In time they accepted markets to some degree despite their ideological embarrassment. The literature on Maoist China is replete with self-confessions about failures to properly balance capital construction projects with building materials or coal and iron goods with transportation requirements.[7]

Markets can *seem* chaotic. Imagine a 12-year-old prodigy being asked to choose between two economic systems: one in which everyone works as much as they want, at whatever they want, while living wherever they want; whereas, in the second, the best minds in the country work together to decide what should be made, who should make it, and where they should make it. The 12-year-old might say, “Hey, that first system sounds neat.” But if he was then asked which system would produce the most economic growth, I think he would choose the second one.

He would be badly mistaken. For one thing, in the second system, political sorts would decide who get to be the planners, and they would be more likely to choose those who will keep them in power than the best economic minds in the country. And, besides, most people could not earn a large income, or even a decent one, if the planners ignored market forces. When I was 12, I thought I wanted to make a living as a professional tennis player. But, in time, I learned that no one would pay to see me play!

The first system actually stimulates planning, but the planning is parceled out; it’s within each economic entity. Innovators think of things that people will want to buy and then plan how to get them made at a reasonable cost. Most would-be innovators are no better at this than I was at tennis, and they may end up earning a salary working for others. But, in time, the free-market capitalist system creates economic growth that produces more abundance and leisure than any other system.

In this book we will seldom be talking about macroeconomics, issues that feature the economy as a whole such as inflation and monetary policy. We will be talking about concepts that economists use when studying particular policies that help make up the whole. For example, in the economics department at my university there are courses on education, housing, health care, labor, antitrust, the environment, and antipoverty programs. The teachers of these courses and most of the analytic staffs dealing with these subjects in governments are microeconomists.

Microeconomists feel misunderstood. All the attention goes to their discipline's showy and presumptuous side, macroeconomics, while its larger, more solid, and more elegant better half, microeconomics, remains unseen. Thus, one can find prominent economists calling microeconomics "the Cinderella side of the discipline" or complaining that "macro gives micro a bad name."[8] We all understand that, when navigating, you want to pay special attention to the part of the iceberg that can't be seen. There would be no cause for celebration if we were spending lots of money on all the particular government programs, but the programs were inefficient and accomplishing much less than they could be.

Economics is a discipline full of both marvelous insights and troubling blindness. Most of this book shines light on the insights. But economists place unbalanced emphasis on narrow self-interest as both controlling motive and route to happiness. I demonstrate the weaknesses in the economist's worldview. I also explain how growing systems of thought such as virtue ethics and positive psychology provide an implicit and sometimes explicit critique of the economist's worldview.

Throughout, I evaluate the views of mainstream economists, those whose outlooks have been shaped by the principles discussed in standard microeconomic or public economics texts. As I use the term, "mainstream economist" encompasses a clear majority of economists – liberal and conservative, Democrats and Republicans.

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Part I

Useful Concepts

1 OPPORTUNITY COST

Thomas Malthus was a nineteenth-century economist who believed that population would always grow more rapidly than food production, thus dooming people to poverty. His economics was called "dismal" by Thomas Carlyle. Economics is still something of a dismal science, though not for the original Malthusian reasons. As the Nobel laureate Kenneth Arrow noted, the economist's frequent job is to say: "This or that, not both. You can't do both."[1]

There is much talk these days of government programs that do not achieve their objectives. The economist, however, sees a bittersweet quality in even those programs that *do* achieve their objectives. The crowd at the ground-breaking for the new community recreation center finds it a happy occasion that will soon make available wholesome sports for the young and community-building opportunities for senior citizens. The economist broods: "Yes, but by spending the money here and not elsewhere, we give up the remedial reading program that might raise low-income students' test scores a full grade, and the new public park in the underserved north end of town. And what about the recreational opportunities that local families might enjoy if the tax dollars to pay for this center were left in their pockets?"

Economists are sometimes defined as those who "know the price of everything and the value of nothing." In their defense, they point out that a concern with prices or costs is really a concern with values. Our brooding economist was worrying about recreation center costs because he cared about slow-learning children and recreation opportunities in the low-income part of town. Added costs leave us with fewer resources available to pursue values in other policy areas. In other words, whenever the costs of one program increase, the expenditures on and benefits obtained from some other program or from private expenditures decrease.

This is the idea of opportunity cost: the understanding that spending and regulatory decisions that use scarce resources or require their use incur costs in terms of forgone alternatives elsewhere. This idea seems so obvious that one can wonder why it is worth discussing. Anyone who has purchased less expensive food at the grocery store in order to pay the rent on time certainly knows something about opportunity cost in the family context.

As I write the revisions to this chapter, in August 2020, a major opportunity cost situation confronts all parts of the country with regard to Covid-19. Take the issue of in-person versus virtual school learning. Children don't learn as much when they are not in the classroom, and their socialization also suffers. But, if they are in the classroom, they will be more likely to be infected with Covid-19. Moreover, with in-person instruction, infections are more likely to spread to other children and teachers, parents and any grandparents living at home.

How many infections could be prevented by changes in schools' classrooms and routines? How great would be the loss of income in single- and two-working-parent families if someone had to be home with children who were learning online? A variety of partial solutions exist for every Covid-19 complication, and opportunity cost defines the costs incurred, or what we sacrifice, in forgoing alternative options. With Covid-19, most citizens' well-being will be affected by any decision that is reached. It is rare for a public policy decision to affect so many people in such a clear and major way.

Some time ago, a high-ranking city administrator in Virginia described his jurisdiction's recreation policy as follows: "We give primary consideration to the public welfare, but cost considerations are also important." Economists worry about this sort of formulation because it suggests that costs are something other than public welfare forgone in other public programs and in the private sector.

For 60 years output and employment in the textiles and apparel industries have been hemorrhaging in the United States. At the same time, firms in these industries have spent very little on new plants and equipment. Economists do not think these facts are *prima facie* evidence of poor industrial management. Textiles and apparel firms hire large numbers of unskilled laborers, and the wages of unskilled laborers here are dramatically higher than in many developing countries. Our firms cannot compete with foreign competitors in these industries, so it is smarter for the nation to specialize in what it is comparatively good at producing, such as making airplanes, and let China and Bangladesh make the T-shirts.

The opportunity cost to society of taking from expanding industries the scarce investment capital needed to modernize declining textile and apparel industries is likely to be so high that the use of antiquated machinery by declining firms is perfectly efficient. Declining industries are always a sorry sight. Individuals who have not studied economics tend to blame the plight of such industries on their antiquated equipment and on the shortsighted management responsible for it. Economists see the equipment as the effect rather than the cause of the industry's decline.

The economically correct response to steadily declining demand is to continue to operate with existing equipment as long as the firm can cover its variable costs of production. That is, if a company can cover its variable costs, any additional revenue it generates can be used to pay off fixed costs, such as paying off loans, which must be paid whether the firm is operating or not. It should rarely replace old equipment. To modernize equipment with high capital costs would make the firm's plight worse, because costs would rise in the face of declining demand and prices.[2]

Even within the same firm a product might be made with advanced technology in one country but not another. The relative opportunity cost of labor and capital still matters. In less developed countries, capital is scarce and labor is abundant. Thus, David Autor, an economist at the Massachusetts Institute of Technology (MIT), notes that Nissan uses robots heavily when producing cars in Japan but relies more on cheap local labor at plants in India.[3]

Opportunity cost reminds us that we should always think about costs, but it also tells us that the costs relevant to decisions are those that are connected to opportunities. Money already spent and resources already used are "sunk costs." They cannot be recovered, so they have no economic relevance for current decisions. As they say, it's no use crying over spilt milk.

But one sometimes hears people say of a government project that too much has been invested to back out. For example, in 1971

Congressman Tom Steed (D-Okla.) said of the proposed American supersonic transport (SST) airplane: "It is a strange thing why some want to stop now. I ask the question: 'If we stop now, who will benefit?' Certainly not the people, for they are going to be stuck for $1.1 billion."[4] The economist responds: "They will be stuck either way. We should ask if benefits will exceed *additional, controllable* costs. If not, don't send good money after bad."

Economists are convinced that few outside their profession truly grasp the significance of opportunity costs. Thus, University of Wisconsin's Burton Weisbrod has said of his former role in the public policy process, "That which we have to offer is fundamentally very simple and second nature to economists but not to others, and I think it's essentially the notion of opportunity costs."[5] Controversial government-funded infrastructure and transportation projects, many of which I will describe below, offer the perfect lens through which to explore this idea further.

Engineers versus Economists

Engineers and economists were at odds about SST initiatives. The engineers wanted to show what they could do. The economists said, essentially, "Even if you can do it, it's not worth it." The economists were right. In the early 1970s Britain and France, cooperatively, went ahead with developing a state-subsidized supersonic aircraft: the Concorde. In 2003 the Concorde made its last flight; *The Washington Post* summed up the adventure as "a technological marvel but a commercial flop."[6]

In emphasizing opportunity costs, economists constantly find themselves quarreling with other experts and professionals. Engineers, for example, frequently provoke economists' ire, as was the case with supersonic transport. Engineers often ponder costs when considering alternative ways to complete a particular project. But a full calculation of opportunity costs requires more than considering the relative costs of using steel or reinforced concrete when building. It also requires considering ways to solve a problem without building at all.

Examples of this kind of oversight abound. Sanitary engineers have equated solving water pollution with the treatment of municipal and industrial wastewaters while giving little thought to lower-cost solutions, including changing the economic incentives to pollute or