

Economic Insights

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Economic Insights is a monthly publication of the Colorado Council on Economic Education, a not-for-profit organization founded in 1974 to promote and improve economic literacy in Colorado schools.

We feel that an understanding of key economic concepts is vital for all citizens in order to live, work and make informed decisions in our modern economy. We sponsor and conduct high-quality graduate courses designed to provide an understanding of important economic concepts to K - 12 teachers throughout Colorado, so that teachers can then bring these concepts to their classrooms. Topics covered include monetary policy, taxation, spending, inflation, the environment, growth, conservation, trade and energy, to name a few.

Markets and the Economic Way of Thinking

You're sitting in your house and it seems unusually chilly for a hot summer day. The air conditioning is roaring away. You get up and check the thermostat. When your suspicions are confirmed — someone has turned the thermostat way down — you know what to do. You adjust the dial to a more comfortable setting.

Or suppose you're heading out to run some errands and when you open the door, it's raining. There's no switch to turn to "off," no dial to set to "dry." You grab a raincoat or an umbrella.

It's easy to divide the world we experience into these two types of phenomena — things like the temperature in your house that are the result of human activity and human intention and things like the rain outside that are not the result of human activity or human intention.

But there is a third category of experience — phenomena that are the product of human action but not of human design.

Language is one example. No one designs or controls the English language. Language experts try to influence the way English evolves

but they have no real control any more than the French government can stop the French people from calling Saturday and Sunday *le weekend* instead of the government-approved *fin de semaine*.

Who decided that "google" and "blog" are words to be used in common parlance without explanation? No one. Because no one is in charge, we might expect language to be chaotic and random. But words don't fall like rain. The evolution of language isn't random. New words stick if they are useful. But no one person is the arbiter. We all are, in some sense. But not in the usual sense that we use the word "we," the sense of a collective decision.

Ironically, we don't have a vocabulary to describe this peculiar form of group action. The speakers of English "decide" which words live and die but not in the way we usually mean the word "decide," which implies a conscious decision. There is no group consciousness.

Commuting time in large cities is another emergent phenomenon. Why does it take so long to get around during rush hour? Whose fault

About the Author

Russell Roberts is professor of economics at George Mason University, a research fellow at Stanford University's Hoover Institution and the host of the weekly podcast, EconTalk.org. This essay is adapted from a longer version, "The Reality of Markets," published by the Library of Economics and Liberty, available online at Econlib.org. Roberts holds a Ph.D. in economics from the University of Chicago, and among a number of publications, has authored *The Invisible Heart: An Economic Romance*.



is that? No one's. Traffic is the result of human activity, but not the result of human design. The time it takes to get from here to there emerges from the complex interaction of the decisions made by those who drive. It has a predictability despite the fact that no one is intending it to be that way. Traffic is slower in rush hour than during the middle of the day. Traffic is slower in big cities than in small ones.

We have no trouble wrapping our minds around the concept that no one individual is in charge of how long it takes to get from here to there during rush hour in a major American city. And even though I drive my car, even though I'm at the wheel, we all understand that I don't control my speed at rush hour. We understand that my speed at rush hour depends on the individual choices of all the other drivers. We also understand that it would be absurd to suggest that "we," all of the drivers combined, have a collective intention that the drive at rush hour takes longer than outside of rush hour. It's no individual's intention. And it isn't the result of a collective intention, either. That concept has no meaning.

Traffic congestion isn't like the rain. In theory, we can do something about it. But the obvious ways of fixing the problem, the ways that are akin to adjusting the thermostat of traffic, don't work

the way people anticipate. Widening the freeways and adding public transit options fail to reduce rush hour traffic for anything other than the very short term.

Consider housing prices. If you move from St. Louis to Washington D.C., as I did two years ago, you'll find that a house in Washington D.C. is more expensive than a comparable house in St. Louis. When I bought my house in Washington, I wasn't angry at the seller for charging such a high price. I didn't blame him for the price discrepancy between his house and a similar one in St. Louis. I didn't express outrage that he was charging almost ten times what he had paid for the house when it was new in 1969. Most people understand that the price of a house isn't really set in any real sense by the seller or by any one person or by any collective will.

Economics is the study of such emergent phenomena, particularly when prices, monetary or non-monetary, are involved. We call these phenomena "markets." That word conjures up either the New York Stock Exchange or a farmer's market, highly organized, centralized interactions between buyers and sellers. But most of what we study in economics called markets are *decentralized, non-organized* interactions between buyers and sellers.

Yet these decentralized, non-organized interactions result in prices, either monetary in the case of houses or non-monetary in the case of traffic, that have an orderliness to them in spite of their not being organized by any individual or even a group. That orderliness, that predictability, runs through our lives in ways we rarely appreciate.

Understanding the emergent phenomena economists call a market is the essence of the economic way of thinking. In contrast, the human brain seems more accustomed to what might be called the engineering way of thinking where human action and human design work together. If I'm dissatisfied with the size of my kitchen, I make a plan and by following the plan, if it's a good plan, the result is a bigger kitchen. A person who sits around hoping for a new kitchen without design or action is going to be disappointed. Or, if I notice the leaves falling from the trees, I have to plan to rake them and then do the actual raking. I don't wait for them to clean themselves up. Changing my thermostat to alter the temperature inside my house is another such example.

But the engineering way of thinking doesn't work with emergent phenomena. Trying to change emergent results is inherently more complex than building a bridge or expanding your kitchen or even

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- Lisa Tousignant, Family & Consumer Science Teacher, Broomfield High School

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putting a man on the moon. People wonder why we can put a man on the moon but we can't eliminate poverty. Putting a man on the moon is an engineering problem. It yields to a sufficient application of reason and resources. Eliminating poverty is an *economic* problem (and by the word "economic" I do not mean financial or related to money), a challenge that involves emergent results. In such a setting, money alone—in the amounts that a non-economic approach might suggest, one that ignores the impact of incentives and markets—is unlikely to be successful.

Consider the average employee at Wal-Mart who earns less than the average wage and has no health care benefits. People blame Wal-Mart for paying low wages or offering inadequate health care benefits. It seems obvious that Wal-Mart sets its wages, but that is as naïve as thinking that the seller of a house determines its price.

My income, for example, is higher than the average Wal-Mart employee. That might fool you into thinking that my employer, George Mason University, is compassionate while greedy Wal-Mart only cares about the bottom line.

But the real reason I make more than the average employee at Wal-Mart has nothing to do with the compassion of George Mason compared to the greediness of Wal-Mart. It has everything to do with my alternatives outside of George Mason compared to the alternatives of the average Wal-Mart employee, just as the price of my house depends on the prices of alternative houses of similar quality.

Many people ask why Wal-Mart has a right to exploit low-skilled workers who have such limited alternatives. The answer is that Wal-Mart isn't exploiting people by hiring them. In fact, the opposite is the case. By creating a business model that allows low-skill workers to serve customers hungry for low-price goods, Wal-Mart *increases* the alternatives available to low-skill workers

and raises their wages above what they would otherwise receive in a world without Wal-Mart.

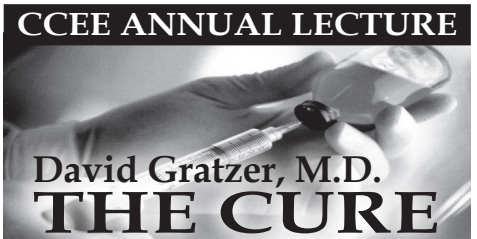
Viewing Wal-Mart as the cause of low wages can lead to destructive policies like banning Wal-Mart from opening a store in your city. When Wal-Mart opens a new store, workers eagerly line up for the opportunity to work there. How can it help them to reduce their opportunities?

It is unfortunate that well-meaning people often join in concert with self-interested competitors of Wal-Mart to hamper Wal-Mart and other employers from expanding. It is tragic when a lack of economic understanding pushes a nation to the edge of economic chaos.

Gas prices spiked upward in the aftermath of Hurricane Katrina when refineries were damaged. Politicians threatened suppliers with legal action for "price gouging." But you can't avoid the reality of markets. You cannot have a sudden reduction in gasoline available to the market and low prices at the same time. There is no dial for gasoline prices. As a result of the political threats to keep prices artificially low, lines formed in some cities, and some stations closed early in the day, out of gasoline, the same results we saw when explicit rather than implicit price controls were put in place in the 1970s.

Friedrich Hayek, in *The Fatal Conceit*, wrote that "The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design." Unfortunately, when politicians try to dial down prices to preserve order, they only worsen the problem. We would do well to remember the emergent nature of prices, especially in times of crisis.

Russell Robert was the Colorado Council on Economic Education's Annual Luncheon Speaker in April 2005.



Can Capitalism Save American Health Care?

Thursday, October 18, 2007

Kent Denver School,
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- Lecture with Q&A
- Time: 5:45-7:00 p.m.
- Tickets: \$20 per person

Why is American health care such a mess? Dr. Gratzler mounts a bold and provocative argument, rejecting the conventional wisdom that socialized health care is compassionate. Instead, he prescribes a dose of capitalism.

The Cure offers a detailed overview of American health care, from economics and politics to medical science. Weighing in on the most controversial topics in health care, Dr. Gratzler makes the case that it's possible to reduce health expenses, insure millions more, and improve quality of care while *not* growing government or raising taxes.

David Gratzler, a physician in Toronto, Canada, is a senior fellow at the Manhattan Institute and peer reviewer for numerous publications. Dr. Gratzler's research interests include Medicare and Medicaid, drug reimportation, and FDA reform. He is the author of the 2006 book *The Cure: How Capitalism Can Save American Health Care*. Gratzler has been cited in the *New England Journal of Medicine*, as well as by such media as *The Wall Street Journal*, *The Washington Post* and *The Los Angeles Times*.



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