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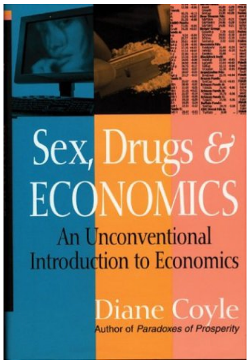

Sex, Drugs & Economics

An Unconventional Introduction to Economics

by Diane Coyle
Thomson Texere © 2002
263 pages

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Take-Aways

- Economics is a way of thinking, not a body of knowledge.
- Economic thought is skeptical and empirical, seeking data and doubting easy answers.
- People marginalize economic theory because they believe in common sense.
- Yet, when economics does clash with common sense, economics is probably right.
- Some popular apparently plausible notions, such as the idea that technology takes away jobs, turn out to be wrong when viewed with economic logic.
- Much of Keynesian macroeconomic theory faltered in the face of facts.
- Macroeconomics teaches: maintain low inflation, forecast carefully, aim for steady growth and try not to mess things up.
- Microeconomics studies economics at the minute level, by examining the decisions of people and companies, not nations.
- These things are true: there is no such thing as a free lunch, supply and demand work, price makes the best incentive, risk and reward usually match and change is constant.
- Economic analysis does not explain why the pornography business keeps getting more lucrative, though it does show why outlawing drugs makes them profitable.

Rating (10 is best)

Overall	Applicability	Innovation	Style
8	**6**	**7**	**10**

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Relevance

What You Will Learn

In this Abstract, you will learn: 1) Some fundamental principles about economics; 2) How these principles play out in sports, business, music and illegal activities; and 3) Some economic rules you can count on vs. some economic myths you should discard.

Recommendation

Most books about economics tend to be rather dry and technical. Not this one. Diane Coyle writes with humor and grace, infusing her erudition into lively prose, never burdening the reader or demanding that you patiently suffer through academic digressions. She views economics not as a subject but as yoga; it's not a bunch of stuff you ought to know but rather a way of learning and reflection. Coyle manages to touch on all of the major contemporary economic issues — literally, sex, drugs and rock and roll — and to make it clear how economic logic relates to such phenomena as sexual behavior, drug taking, war, fashion, major league sports and the Internet. This is an interesting, amusing book by an excellent author, both saucy and unconventional. *getAbstract.com* knows that it might not help you make a lot of money — it's not that kind of book — but believes that it will make you richer in other ways.

Abstract

Economic Thinking

A lot of nonsense pours out of television and radio speakers, peppers newspaper and magazine articles, and colors political speeches and legislative initiatives. Dunderheads deliver absurd economic diagnoses but knowledgeable experts fear to contradict them. Economics has its roots as a science in the skepticism of Scottish philosopher and historian David Hume (1748-1891). Its original name, "political economy," is a better description of what it is about than the contemporary word, "economics." Economics is not a subject or a corpus of knowledge or a set of facts, but rather a whole way of thinking about and looking at social issues, political problems and business or financial challenges.

"Economics is essentially a particular way of thinking about the world that can be applied to almost any situation affecting individuals, companies, industries, and governments."

Economists concern themselves with how people try to get what they want when their resources are scarce. What choices do they make and how? What happens under the pressure of change? Nothing could be more practical, so why do many people consider economists to be ivory tower eccentrics, out of touch with the mainstream? Although economists do rely heavily on complex mathematics to describe the world as they see it, their concerns are not at all remote. Recent economic research has focused more and more on the so-called "real world." In fact, 90% of the articles in the *American Economic Review* have addressed practical problems. Yet, people ignore or marginalize economists for three reasons:

"One economist mused that the real puzzle was not why so many women became prostitutes but rather why so few did."

- Innumeracy — Some very influential people are inept at math. People are apt to disdain what they do not understand, and economists do communicate using math.
- Common sense — Many of the theories and prescriptions economists issue seem to contradict common sense, which is a kind of received wisdom that may be true or not, but that resents contradiction. This problem is compounded by the fact that many economists cannot express themselves intelligibly and in plain English.
- Macroeconomic hubris — The macroeconomic branch of the study of economics has too often proposed fine-sounding theories that made no practical sense, and failed.

"The policy of absolute prohibition — enforced by most governments of countries that import illegal drugs — has created a parallel economy controlled by organized crime."

Globalization and Other Economic Misunderstandings

Consider a typical argument against globalization. Critics of globalization say that multinational companies take good-paying jobs from developed countries, relocate them to undeveloped countries, pay workers horribly low wages to manufacture products, then ship the products back to the developed country. Everyone loses; it seems, except the exploitative company. This sounds plausible and somehow repugnant. But in the light of economic logic, it makes no sense.

What actually happens when a multinational relocates a factory from a developed to an undeveloped country? The undeveloped country gets an investment: the factory. Then the multinational hires local workers. How? By paying them more than they can earn other ways, so they are better off. Multinationals are not exploiting them; they are improving their lot. Substantial evidence shows that salaries and working conditions in multinational corporation's factories in developing countries are superior to prevailing local working conditions. What about workers in the developed country? Except for those who lost their jobs when the plant moved, they're better off because now they can buy a good product at a presumably better price. Multinationals move to compete more effectively, a powerful force in lowering prices. Even those who lost their jobs may wind up better off in the long run. There's no future in doing a job someone else, somewhere else, can do just as well for less.

"The difference in salary between a teacher and Tiger Woods is explained not by differences in how society values their contributions but by the economics of scale operating in their respective professions."

Here are several other misguided notions that seem plausible but that turn out to be dead wrong when viewed with economic logic:

- Government should protect or subsidize key industries — No one can rank industries by order of importance. Is the auto industry more important than the food industry? As technology changes, industries come and go. This is a fact of economic life.
- Cutting the work week will boost employment — Sounds reasonable, because if all existing employees work fewer hours, then employers will have to hire new workers to take up the slack. But, in fact, cutting the work week will raise costs because employers have to pay the same for less work. Higher costs can lead to higher prices, which often mean lower sales, which can lead to employment cutbacks.
- Immigrant workers take jobs from native-born workers — Immigrants increase the supply of workers, which may lead to a fall in wages in some jobs. Usually, these are unskilled, low-paying jobs that native-born people are not eager to take, such as picking lettuce. The number of jobs rises or falls depending on the cost of labor.
- Technology takes jobs — In fact, technologies that reduce the need for labor lead to more and better jobs. Many of the jobs that lend themselves to automation are boring, routine and repetitive. When a robot can do a job for less money than a person, the company automates. Then, it can cut prices or invest its savings in more production facilities. Consumers benefit from lowered costs, increased supply or both. The company benefits because it sells and earns more, and may return money to its investors to put into other enterprises. The net effect is to create more jobs. This is hard luck for the worker who loses a job to a machine, but it may be not so hard, because that worker's skills might be more lucratively employed elsewhere.

"The tax is high because of the health costs of tobacco and alcohol consumption. The government would prefer a sober and clean-living workforce."

Facts and Bad Data

Despite the ubiquity of computers, much economic analysis uses bad data. Economists and the general public must learn to doubt data and demand that it prove its own worth. Sometimes economic arguments rest on erroneous numbers. At other times, polemicists cite numbers out of context. Learn to understand the size of the economy so you can comprehend what a $100 million rise in retail sales means, or how burdensome a $50 billion agricultural subsidy will be. Many people cite widely accepted but wrong "facts" such as the notion that President Ronald Reagan shrank the size of government. Good economic thinking demands good evidence, and the first step in economic analysis is to test the facts.

"It is easy to condemn multinational corporations — easy, but in the end wrong."

Macroeconomics

Macroeconomics is a branch of economics that fell victim, more or less, to facts. For much of the twentieth century, Keynesianism — based on the thoughts of British economist John Maynard Keynes (1883-1946) — dominated macroeconomics. Keynesians believed that government could play the economy like a piano, adjusting employment and output by manipulating government spending and the money supply. The facts proved them wrong. Instead, lately, macroeconomics has backed away from overarching theories to focus on practical issues, such as productivity.

"Abolition of farm subsidies would certainly put many farmers out of work. That would be the point."

Usually, the problem with any macroeconomic theory is an absence of supporting facts. Of course, macroeconomists can't mix economic variables in a test tube and see what happens. Macroeconomics defies experimentation and deals with a social construct, the economy. Economies change because people change. Economies are not machines, so forecasting an economy's behavior is nearly impossible. The best macroeconomics can deliver is a few principles summed up in the phrase: don't screw things up. This translates into:

- Maintain low inflation — Best by entrusting the money supply to central bankers.
- Aim for high but steady growth — When you have to pick one, choose steady.
- Forecast with caution if at all — Specify confidence intervals or margins of error.

"Economics is often described as the dismal science, but nobody can beat environmentalists for gloom."

Microeconomics

Microeconomics is the study of economics at the minute level. Microeconomics looks at the economic choices of individuals and firms, not whole countries. These interesting questions lend themselves to microeconomic analysis:

- Prostitutes make great money, have a lot of job flexibility and do inside work with no heavy lifting. So why do so few women choose to turn tricks? And why is the sex business in general so profitable? Conventional economic analysis suggests that the profits from prostitution and pornography ought to fall to nearly zero as a result of market forces. Why does the sex biz remain a gold mine?
- Why do people do risky things, such as smoke, drive cars fast and take drugs? Given rational economic behavior, a person would carefully weigh the costs and benefits, and decide that the risks don't justify the benefits. Why doesn't economic theory explain this reality?
- Why do sports stars make so much money while teachers make so little?
- Does it makes sense for developed countries to subsidize their inefficient farmers when farmers in the developing world are eager to supply produce at lower costs?
- What is the best way to conduct an auction for the spectrum used by mobile phones?

"There are countless examples of how business taxes fall unnoticed on unexpected groups of people."

Unlike macroeconomics, microeconomics lends itself to the experimental method. You can't put a national economy in a room and watch it make decisions, but you can test individual's decision making processes. Some fruitful microeconomic efforts have addressed industrial regulation, bankruptcy laws and even new discoveries in sociology and criminology.

"Disease control not only benefits those who are ill but makes everybody else less likely to fall ill in the future."

Behavioral economics lies at the intersection of economics and psychology. This form of microeconomic analysis looks at the people's choices and tries to explain why they are often irrational. For example, the stock prices of companies in the same industry vary more than the stock prices of companies in the same country, even if all of the companies in the industry are in the same country. In 2000, Daniel McFadden and James Heckman won the Nobel Prize in economics for their advances in behavioral economics — a nod of approval to the fact that the irrational may be indispensable to the dismal science.

The Economic Rules

For an overall understanding, remember these ten basic rules of economic thought:

1. There's no such thing as a free lunch — Everything costs something. Every decision is an economic choice, and the cost of what you get is what you don't get.
2. Change is constant — Many economic cases stipulate "*ceteris paribus*" or "other things equal." But other things are never equal. People change; thus, the context of economic policy changes. It is possible and imperative to consider what will change.
3. Time bombs never go off — In 1968, population doomsayers predicted an overpopulated, starving world. Instead, the world got richer and population growth fell. Now, instead of a glut, the world seems to be facing a population shortage. It is probably safe to suppose that something will change again, something unexpected.
4. People respond to prices — Government policy makers should remember that prices motivate conduct better than regulations. People love a bargain and hate to overpay. But, usually, they will be very creative about finding loopholes in regulations.
5. Supply and demand is effective — Cut supply and prices will go up. This is why the war on drugs is self-defeating. Drug prohibition drives up prices and makes the drug business worthwhile despite the risks of jail.
6. Risks and rewards are generally commensurate — There is no reward without risk and only big rewards can justify big risks.
7. People will have their way — People will usually make rational, informed economic choices. For example, if government regulations drive up wages, industry will leave for less costly climes.
8. Evidence matters — A lot of economic commentary is ill informed and based on bad data. Always question the data underlying a hypothesis or polemic.
9. Common sense can err — When common sense and economic logic clash, common sense is commonly wrong. As Will Rogers once noted, it's not what we don't know that hurts us, but the things we know to be true that just aren't true.
10. Economics is not really a dismal science — Actually, it is the study of happiness. Economic analysis aims to understand how people make the best of things, and how to make things better.

"Whatever the explanation, history offers no examples of countries that combine declining populations with economic vigor."

About The Author

Diane Coyle is a regular columnist for *The Independent*, a presenter of BBC Radio's *Analysis* program, and author of *Paradoxes of Prosperity*, *The Weightless World* and *Governing the World Economy.*

