Harmful Fallacies in Economic Discourse
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Harmful Fallacies in Economic Discourse

Mason Gaffney

"*Satan deludes youth with beauty, the miser with gold, the leader with power, the learned with false doctrine*." -- H.G. Bohn

I. Generic Fallacies

G-1. Fallacy of Inverting Cause and Effect.

a. Fallacy that trade deficits result in capital inflows.

b. Fallacy that high rents result from high land prices.

G-2. Fallacy of Identification (identifying idea A with idea B, when they are different). The Fallacy entails confusing the incidental with the essential; connotation with denotation; myth with reality; etc. It entails the stereotype or *Gestalt* or paranoid-"pattern" view of life, an enemy of analysis and clear thought. The Fallacy of Identification really means *mis*identification, or confusion. Block phrases often contain or foster this Fallacy.

a. Example: identifying dissipation of rent (owing to open access to lands, fisheries, etc.) with dissipation of monopoly profit (owing to open access to markets).

b. Example: a tax that looks regressive at the national level, because it is a *local* tax, becomes a block phrase, "theregressivepropertytax." In result, policies are proposed that do not serve the ostensible end: in this case, shifting to the sales tax, a very strange way to help poor people in poor regions.

c. Fallacy of identifying (confusing) discontinuity with indivisibility.

d. Fallacy of identifying (confusing) Long-run Marginal Product (LMP) with Marginal Net Product (MNP).

e. Fallacy of Identifying Scale with Efficiency, using the block phrase "Largeefficientfirms."

f. Fallacy of identifying (confusing) "economic man" with "pecuniary man." An economic man often sacrifices money for other values, e.g. leisure, the desire to leave an intellectual legacy, welfare of grandchildren, honor and glory, etc. Rationality is just a means to gratify desires that may be sentimental.

G-3. Fallacy of Straining at Gnats while Swallowing Camels.

Example: saying the main cause of waste in government is the high salaries of elected officials, including those who fight waste. This kind of thing gets self-righteous and mean-spirited. It may be heard on Channel 9 at 7:30 PM, weeknights, along with other cheap shots.

G-4. Fallacy of False Parallels, irrelevant analogies ("pigs is pigs," even though one of them is a guinea pig).

Example: fallacy that labor income is the same as land income, just because each is called "income."

Rather, labor income is gross of costs of birthing, rearing, medical care, education, care of the aged, and depreciation of and interest on these if they are capitalized.

G-5. Fallacy of Absurd Overinterpretation,

Example: talk about conserving energy, or capital, and you hear this: “You want us all to go back to the spinning wheel with Ned Ludd and Mahatma Gandhi?”

G-6. Fallacy of Not Specifying Denominators (Ignoring the Base of Ratios)

a. Nation B is twice as urbanized as nation A; therefore A is twice as rural as B. (False because B is only 2% urbanized.)

b. A bought half of B’s remaining land; therefore A doubled his acreage.

c. I can do 105 pushups; (I start counting at 100).

d. Rates on unstated bases: “the rate fallacy.”

Example: GM’s profits are 20% (of what? Sales, net worth, value of shares, historical cost, etc.) Here, the Fallacy is compounded, usually, by fuzzy definitions of “profit.”

e. The “-ity” fallacy: vague use of productivity; parity; profitability; intensity; rentability; durability; salability; usability; etc. Add “-ity” intimidates the reader without adding weight to the root word.

f. “Efficiency” (output/input) w/o specifying input.

g. Treating a closed system like an open one. Examples follow.

i. People entered a night club at a constant rate per minute. As the room became more crowded, the fire marshal became less concerned because the % rate of growth of the crowd inside kept falling.

ii. As Elmer approached 95, his life insurance premiums fell because each year he added a lesser % to his life.

iii. After the home team gained 97 yards from its goal line, each additional yard meant less because it was a lower % of the base.

(Obviously, in all three examples, one should relate changes to the low base of what remains, rather than the high base of what went before.)

h. The Base Year Fallacy. Measuring fractional changes from a base year that is chosen to strengthen your case.

Example. Farm “parity” prices (terms of trade, actually) are those that obtained in the most favorable years in history, 1910-14.

Example. Your salary has risen 30% while mine rose only 20%. (But who says they were correct to begin with?)

G-7. Fallacy of Composition (non-system thinking)

Example: “What’s good for General Motors is good for the country” - (Charles Wilson, ca. 1956). See also D-7, about advocacy of farm price supports.

Second Example. In planting an acre with orange trees, add a 40th stem. The resulting tree will bear 50 lbs of fruit.

Fallacy is to say the marginal product of the stem is 50 lbs (you have to subtract the reduced production, due to crowding, from the first 39 stems). This is also the fallacy that the marginal product equals the average product.

Third Example: a 57th fishing boat joins the fleet and catches 350 tons. This is its marginal product.

This fallacy equates MP with AP; overlooks "tragedy of commons," etc.

G-8. Fallacy of Partial (usually Selective) Constraint.

Example: fallacy that cheap money causes people to build on land more intensively. Rather, they buy more land, lowering intensity. Cheap money also helps one build, but its comparative advantage is in buying land, whose carrying cost is mainly interest (no depreciation).

Example: fallacy of stressing that "capital gains" during inflation are phantom income that should not be taxed, while ignoring other kinds of phantom income (like interest on savings accounts). It is worse when the advocate also ignores real, but untaxed income that results from fall in the real value of debt, and of deferred taxes (notably, taxes on capital gains themselves).

Example: fallacy that property tax should be abated to spare rich widows, on welfare grounds, ignoring poor widows who rent and need welfare from property taxes on rich widows, and others.

Example: fallacy that wealthy people use less energy because they have the capital to insulate houses. Rather, they buy bigger houses. Also, similarly, to stress that cheap credit lets one conserve energy by insulating a 5-rm house, ignoring that it also lets one move to a 7-rm house and use more energy.

Analogy: selective, partial Bible fundamentalism, in which a "Christian" is one, and only one, who would punish homosexuality and abortion. At the same time, another person who cites Bible passages urging forgiveness of sins, redistribution of wealth, forgiveness of debts, the evils of avarice and "laying field to field," the unlikelihood of rich people getting to heaven, driving money-changers from the temple, etc., is an atheist and communist.

G-9. Fallacy of "Ahistorical" Theorizing, and other theorizing that runs contrary to observable facts. This is "Economics without Man" (Horace Gray). It deludes you into thinking people behave like pieces on a chess board, following arbitrary, simple rules that may be assumed before the analysis begins, and seem to give determinate answers to indeterminate problems.

Example: equating opportunity cost and cash cost as economizing incentives. This is perhaps an improvement over the reverse fallacy, that is treating o.c. as = 0, but in their false pride, preening themselves on refuting the first fallacy, micro theorists fail to observe how humans actually behave, how credit rationing works, and how cash drains lower the liquidity, income, and wealth of the payor.

This error is especially misleading w.r.t. land, whose hoped-for price increments offset opportunity cost of holding.

G-10. Fallacy of Counterfeit Wisdom through Hedging (Cf. 11, Fallacy of Reifying Metaphors.)

Many grant-needing institutions, dominated by nervous treasurers, develop a recognizable style of hedging, perfected through lifelong habituation to bureaucratic gobbledygook. They want to show they have covered all the bases, see the merits and demerits of every proposal, and are committed to none. Combine this hedging (aka ass-covering) with reifying metaphors, mixing metaphors, backing and filling, larding with incontrovertible bromides and tautologies, reliance on empty words and repetition, avoidance of offending anyone or specifying anything, and you get the following mush, cited from an actual Report of a well-known Institute.

".. demand for real estate products ... snowballed into a wave of speculative overbuilding ... (Later,) the speculation-fueled binge gave way to stagnant markets and soaring vacancy rates. ... with effects on the fabric of society itself.

Economic analysts differ on the relative importance of the real estate cycle to the economic performance of metro regions. A convincing case can be made, however, that the boom-bust cycle may make some places overpriced in relation to other, less expensive places. This in turn affects others.

The boom created massive numbers of jobs, income, and great wealth ... . It also destroyed the cost structure, and later was responsible for the loss of thousands of jobs ... Other jobs depended on those; these jobs, too, vanished as the bust wiped out these largely ephemeral gains.

Many believe that the rationale for public attempts to regulate the boom-bust dynamics of land and real estate markets is fairly straightforward. Others are reluctant to see government intervene in the market. Either way, regulatory activities have important effects ...

Unstable revenue flows make budget planning difficult. ... Yet a variety of techniques ... all hold some promise of dampening (*sic*)[1] boom-bust cycles within existing frameworks of governance.

... the more information that elected officials, planners, developers, and citizens have about market conditions and growth trends, the more likely it is that policies can be developed to accommodate growth without a speculative boom ...

Some believe ...; others, less optimistic, believe ... There are drawbacks and limitations, however, ... In contrast with the argument that land-use regulation is a panacea for problems rooted in the boom-bust cycle, X suggested that controls are not directly useful for regulating real estate market cycles. At best, these tools have little or no effect; ... Ultimately, the choice is a political one ...

It has been argued that impact fees increase the "economic efficiency" of each development decision ... Yet, imposing such fees may or can increase housing costs. "A" asked ... ? In contrast, "B" maintains ... It is generally agreed that land use planning for urban service areas will stabilize real estate markets if .... It can be a daunting task, however, ...

A provision of this sort would benefit local governments but might anger taxpayers. Another possibility would be ... However, the results have been mixed ...

[1]You "damp" a cycle; you dampen clothes before ironing.

The most important step is to avoid raising the tax in booms ... but the effect may be marginal ... would have a limited effect ... It remains unclear, moreover, how such a tax can be structured to do its regulatory work while also being politically acceptable. In Z's opinion, (this tax) set high enough to influence behavior would probably be unpopular with voters. ... it ignores several problems. ... downturns are precisely the wrong time ... to impose tax burdens any higher than necessary.

Clearly, it is desirable ... to avoid ... taxes that respond to construction and new development activities. ... development exactions can be an integral part of such a long-range approach to finance.

One factor that can trigger a speculative boom is overstimulating development ... Such conditions can create problems ... The development industry may act as a flywheel ... such a spiral ... may lead to a collapse. Growth coalitions orchestrate the scope and pace of development ... This raises questions ...

The ebb and flow of the cycle ... prices increase steeply and quickly then crash dramatically ... in areas with rapid growth. ... these growth pressures then interact with constraints on land supply, and with psychological dynamics to produce the boom-bust profile. The dynamics of the boom-bust market can become a major factor in driving regional economies both upward and downward, ... and can undermine fiscal health.

Conclusion: Ultimately, metro form is the result of complex interactions of an ever-changing economy , ... We must envision new relationships among these elements and make new choices."

[Does that make it all perfectly clear? Have you learned anything at all from all that? Have you any idea what these experts recommend? Not surprisingly, the author hides behind the Institute and does not identify himself. Why should he? He has not specified anything else.

G-11. Fallacy of Reifying Empty Metaphors.

What follows is taken from two actual articles. Economic writing is full of this stuff, as reporters try to sound worldly-wise about matters neither they, nor their interviewees, understand. When their readers are done, they will not understand, either.

a. "Tough fiscal measures; favorable balance of trade; bite the bullet; the economy would climb out of the recession to a growth rate that would get industry moving; the upturn has been sluggish; global recession threatens to undermine our economic take-off by hitting exports and keeping prices subdued, dampening (*sic*) activity and boosting unemployment; markets are skittish; jittery markets want to see action; high demand sucked in imports and caused a blowout, so the government had to drive interest rates through the ceiling to dampen (*sic*) demand; ditching the cuts would throw a wrench into relations with unions; we must implement tougher arrangements; government may pull a rabbit from the hat, sending a signal to markets; government has yet to cut spending to the bone - it needs to set out a plan with flesh about the bones."

b. "The economy is on a roll; how to rein it in before prices spiral out of control; having unleashed many of the nation's communist fetters, Chinese leadership now must tame its firebreathing, unruly dragon of an economy without putting it back in chains; cool inflation by

clamping down on credit; controls were eased to funnel money to state-owned firms that were drowning in red ink; the situation is by no means encouraging; chaos has appeared; banning profiteering; they are only a temporary salve for the economic woes; the rusting state sector is hemorrhaging red ink; inefficient enterprises are due to be bailed out or allowed to go bankrupt; the solution to the dilemma is macroeconomic fine tuning; the government needs macroeconomic tools."

If you use metaphors, stick with one or two. A metaphor is effective when it calls up a physical image that can serve as a reasonable analogue to what you are really talking about. When you mix them, it shows they are just empty words you picked up from someone else. Try to create your own, from your own experience and observation: then they'll be original, and have impact, just as the tired clichés did when they were new.

G-12. Fallacy of Compartment-mindedness.

Toleration of contradictions by assigning them to different compartments (e.g., Micro and Macro). Holding two contrary views at the same time. Failing to seek consistency in one's beliefs, to reconcile and compose contradictions. (Orwell called this "double-think.")

Example from capital theory. Many will say that the PIPO model, as used by Böhm-Bawerk and Wicksell (the "grape juice model" of a macro-economy) only applies to grape juice, and things like it. With other capital, other principles apply. This leads to fallacy that the period of production, or of investment, is indefinable, unmeasurable, and/or meaningless. Worse, leads to the fallacy of the disappearing inventory (F-6), where "normalizing" or staggering investment cycles makes input and output simultaneous.

G-13. Fallacy of the Unrecognized Self-necessitating Policy or Action. Some examples follow.

a. Condemning land for a rail station, using a price that is inflated by the prospect of the station's being built. (You think I'm making this up? This is exactly how S.P. squeezed $84.7M out of Southern California Metro Transit Authority (MTA) for the Union Station in L.A., in 1984.)[2]

b. One absentee landowner performs the service of bearing the financial burden of ownership for the tenant. However, as a social and public policy matter, this overlooks that absentee owners collectively provide extra investment demand that pushes up the price of land. The higher price is out of reach of tenants, which is what keeps them tenants. Such a "service" vouches for itself; it creates the very need that it meets.

c. Another example. It is a common administrative ploy to underfund a department, then use its poor performance to justify funding it less. This is kin to "blaming the victim."

d. An example is the idea that taxes can come out of wages. Why can't they? Some workers at the bottom barely survive, cannot be taxed. Progressive income tax rates are an attempt to tax workers who get above the survival level. However, these skilled workers have invested effort and capital to raise themselves. Market forces would have them invest just that extra effort and waiting needed to get them to their desired level. If we tax away the premium

[2]This was the largest condemnation award since eminent domain was established in 1250 A.D.! One wonders if the RTD might be in less soup today if they had spent that money on better construction in the tunnels.

earnings, the same forces will make them demand - successfully - that much more before taxes to return their after-tax incomes to their relative standing absent taxes. That is, if one believes in market forces.

G-14. Fallacy that TANSTAAFL.

Rather, TITSATAAFL (There Is Too Such a Thing As A Free Lunch). Examples follow.

a. Improved allocation is free lunch. The “win-win” deal, if real, is a free lunch.

b. Putting idle workers in good jobs is a free lunch. So is using idle land, if the use is environmentally benign, and pays net rent.

c. Many positive feedback loops are free lunches. Examples: thawing a frozen market; pooling risks; pooling supply and demand; creating confidence.

d. Synergy. Spillovers, or “external economies” (which Ellis-Fellner, Mieszkowski, et al. would like to define away).

e. Removing barriers to better allocation of resources.

f. Doubling the welfare of A by dropping B by 1%, etc. E.g. Switching one acre from the owner of 200,000 hurts him less than it helps a donee who has just one. In individual cases, this could be wrong, but on the average it is bound to be right much more than wrong.

g. Sharing public goods is a free lunch. (“Public goods” are goods whose use by more persons does not interfere with use by present users, or others. Thus, they are supplies whose Marginal Cost (MC) = 0.)

h. Land rent and gains are a free lunch. The question is, who gets them?

i. Moving toward more equal % shares is likely to improve allocation, e.g. reducing farm water 5% to increase industrial water 100%.

j. Any policy that breaks an impasse is a free lunch. Especially policies that compose two problems into one solution. Example: the fear of overproduction should allay the fear of inflation, result is to level supply and demand upwards.

G-15. Fallacy of Incommensurability

Example: The wealthiest Americans, those with $250,000 or more in personal income, have XX% of the income.

[Income is not a measure of wealth. Income is a flow over time; wealth is a balance sheet measure at a point of time. Some with high measured income have little or no wealth; some with high wealth have little measured income, e.g. if they are “land-poor.”]

Example: Sales of GM > Switerland’s NNP. (NNP measures value-added; GM sales are gross of purchased components, materials, etc.)

G-16. Regression Fallacy

This is when you rank people by one measure, then judge or measure what they have of another.

Example: the shortest 10% of the people had only 4% of the total height in 1980, but by 1990 had grown to have 7.5% of the total height. Therefore, heights are getting more even.

Example: the smartest 1% of the population in 1880 (say, those with i.q.s over 150) had a generation of children, most of whom had i.q.s under 150. Therefore, the smartest few are becoming more like the average person. (This is called "regression towards the mean," and is the origin of the "regression" in regression fallacy.)

G-17. Fallacy of Infallibility of Authorities

"After you've won your first Nobel prize, perhaps you may disagree with Galbraith or Stigler."

"Scientists agree that ... "; "Science says ... "; "Science has proved ... "

"Economists take their production functions from engineers ... "

"Good forestry cannot pay interest at going rates. Therefore, interest rates have no place in calculating good forest practice." (I am not making this up - see any forestry textbook.)

"Professional Foresters determine what is good forestry; engineers determine proper standards for structures and equipment; medical doctors determine what is sound medical practice; etc. Meddlesome accountants must not interfere with these professional judgments, based on professional codes of ethics framed to protect the public interest."

Another view: "An engineer is a person trained to tell you the very best way to do something that should not be done at all." - Kenneth Boulding, evaluating the California Water Plan.

G-18. Fallacy of Analogical Argument (inferring a further degree of resemblance from an observed degree; two things are the same in all respects because they are alike in one respect).

Example: red flannel underwear keeps you warmer because red is the color of fire.

Example: wage income is unearned, just like land rent, because it is higher than opportunity cost; or because "it is a differential"; etc.

Example: man-made capital is just like land in all respects because both have a present value derived by discounting future cash flows.

G-19. Fallacy of Tautology: making a definitional statement seem like a causative one.

Example: "Soaring yields send bond market into a sharp decline."

G-20. Fallacy of Absurd Oxymoron

Example: "This recession ended in 1991. The unemployment rate and the poverty rate kept rising after the recession ended."

Example: "Jobless prosperity."

II. False Performance Standards

PS-1. Fallacy of Partial Maximization.

This is the Fallacy of Maximizing Average Product (AP) of just one input, (usually labor), ignoring cost of others. You have been warned against this in Micro-economics, but probably not often enough. Economists who should know better are frequent violators: they haven't even listened to themselves.

"Productivity" has become a buzzword leading to error, and often to ruin. The AP of a Variable Factor (VF) is a max where the Marginal Product (MP) of the Fixed Factor (FF) is zero, and vice versa. That is, You (the boss) max the partial AP of one input only by wasting all others. Not smart.

Don't judge the salesman without looking at his territory; don't judge the professor without looking at his labs, experimental plots, and budgets; don't judge the farmer without valuing his land; don't judge the nation without looking at its territory.

a. Fallacy of single-factor efficiency. Every input has its zealous champion who would economize only on it, or produce only one output, and measure performance accordingly. Some value only labor, others energy, foreign exchange, food, fine arts, ATVs, endangered species, habitat, fishing, sex in its various forms, abstinence from sex, minority rights, majority rights, women's rights, men's rights, the environment, speed, highways ... you name it, there's a freak for everything.

A good manager (or a good statesperson) recognizes single-valued fanaticism, and holds these fundamentalists in check. He must reconcile their demands: not with simple-minded personal compromises, but with good economic analysis. Sometimes, with ingenuity, he can compose them into a synthesis that is better than a trade-off, achieving much of both or many goals. Marriage, for example, has been known to satisfy the needs and overcome the loneliness and insecurity of both parties. Now <u>that</u> is good managing (when it works out); it takes good thinking.

b. Fallacy and Folly of Setting Naive Records ... like max sales, gross output, budgets, height of building, speed of travel, size of office, area of spread, cost of facing, fullest use of damsite (e.g., highest possible dam), most perfect flood control, max output of forests and mines (aka "low-grading"), greatest assets of firm or bureau, etc.

All those fallacies involve ignoring Marginal Costs (MC) in Stage II,B of the production function. Stage II,B is that part of Stage II wherein $0<VMP<MC$. Some of them can even carry you into Stage III, where the VMP of the VF is <0; and Stage I, where the VMP of the FF <0.

The costs most often overlooked are imputed interest and rent on owned assets. They often result from overacquisition or overretention of land caused by Malthusian apprehensions, guarding against anticipated monopoly, storing up for possible future needs, holding for the rise, securing boundaries, avoiding sales to hide market values from tax assessor, sharecropping, inflating rate base of utilities, etc.

Here are some more examples.

c. Maximizing yields per unit of land (the most corn; the tallest building).

d. Maximizing sales

e. Maximizing “return on sales.” This is the same as max AP of variable inputs, ignoring value of fixed inputs.

f. Minimizing costs/output. Same as max AP of sum of variable inputs. (This is a Fallacy *unless* “costs” include all fixed costs, marked to market.) It is better than max AP of just one input, e.g. labor, but what is just “better,” while still wrong, is often more dangerous than what is blatantly wrong, because harder to detect.

g. Beware of something called “benefit/cost ratio” (used in project analysis). It is the AP of everything included in “cost,” but often owned inputs are omitted, leading to wasting them when you max this ratio.

In fine, AP is a dull tool for dimwits. Don’t be one. Its main use is for blurring issues and supporting fallacies.

PS-2. Fallacy of Arrogation

The Fallacy of Arrogation is imputing to B the product of A’s effort or saving. Its committers include most of those who oppose marginal analysis. A theory may be understood better by understanding its opposition. Whom does it threaten? Marginal analysis threatens all who gain by Arrogation. These groups jointly form “The Omelette School,” so-called because their slogan is “you can’t unscramble an omelette.” They resist even scraping the omelette off the skillet, so they can avoid analysis. Arrogators include the following.

a. On the extreme left, those who believe that “labor produces all value.” This now includes workers in fat industries, where elasticity of production is low, who would like to claim their AP. In syndicalist economies (worker control of plants, one by one), such as recently found in Yugoslavia and parts of China, some workers got good plants on good sites, others got marginal ones. Those in the better plants claimed they produced all the value.

On the moderate left (Bertrand Russell), those who believe that production is cooperative and it is impossible to impute specific amounts of production to specific inputs. (Note how people often call something “impossible,” when they really mean they think it undesirable on other grounds. Russell, for example, thought imputation to specific inputs is destructive of cooperative spirit, and hyperindividualistic).

b. On the extreme right, Tory rent-takers who seek to blend in with productive management, and/or with savers who create capital, and take credit as managers or savers for the high AP of labor.

c. Anti-rationalists who find it hard to follow analysis. The world is full of these, seeking some easy rule to follow, so they needn’t think. They are easily stampeded by those who are perfectly able to follow the analysis, but do not like its findings.

d. Managers seeking to overstate their performance. Fallacy of understating true capacity of fixed input to yield rent.

Let G=Ground Value (annual), P=Product Value, and W=Work input. Consider the ratio, P/(G+W). As G approaches zero, the ratio approaches P/W. Then max P/W looks like max efficiency. Managers do that routinely, to make themselves look better -- a Fallacy of Arrogation, meaning they are arrogating to their credit the output properly imputable to the fixed input.

They do this by carrying land on the books at historical cost, and by ignoring associated costs, complementary costs, allocated overhead, etc. They fight like tigers against marking to market, reserve recognition accounting, and such obvious devices for entering owned inputs at their true values.

PS-3. Fallacy of Maximizing Usable Life of Capital (ignoring re-use value of site it preempts).

a. In commercial forestry (where trees are valued for lumber content only), that might mean maximizing growth per tree, an extreme error (except to "tree-huggers," but that is another issue not addressed here). Or, it might mean letting trees stand and grow so long as current growth covers interest on the liquidation value of the tree (thus, in effect, earning no return on the land). This is the fallacy that financial maturity arrives when value of current growth just covers interest in harvest value of tree, leaving nothing to cover rent of the site. Most economists fall into it - they are trained to overlook land values.

b. Building extra durability into dwellings, cracking towers, boilers, vehicles, etc., to "spread the overhead" of capital outlay over more years. This position is advanced with great self-righteousness about the alleged "myopia" of those who act otherwise. It overlooks at least three things:

i. The extra cost of the capital tied up over many years to provide the durability;

ii. The fall in the present value of the reuse value of the space occupied;

iii. The waste of capital resulting from obsolescence in its many forms.

PS-4. Fallacy that Optimum is max MP, or TP

PS-5. Fallacy of Overvaluing Foreign Exchange (relative to earnings of domestic currency).

a. In international trade and lending, this leads to maximizing exports, without regard to cost of imports. It is treating foreign exchange as though it were inherently worth more than domestic currency (at the market rate of exchange). Foreign lenders have always pushed this one hard; they still are, through IMF and World Bank. These agencies with this attitude are doing a good job of giving free trade a bad name. (Through a confusion of terms, their views are now labeled "monetarism.")

b. A variation on this idea, in local affairs, is the Fallacy that Import-competing Firms are Nonbasic and Parasitic, so a city should court and subsidize firms that export, "bringing money into the community." The Riverside Chamber of Commerce has long been in the fell clutch of this fallacy, treating little local import-competing businesses like poor relations. Bringing money in is presumed to be more worthy than keeping money from flowing out.

PS-6. Sometimes the reverse fallacy is in style, Undervaluing Foreign Exchange or Trade relative to domestic currency or trade. This is the way of "Autarky" (self-sufficiency). It was long practiced by Canada and its various Provinces, which would supply the local market with cheap oil and gas, rather than export it at much higher prices (even after NAFTA, I doubt if this practice has been rooted out). Russia still does this, so everyone can stay warm at 20 below zero, and you have to open the windows to avoid overheating your room. In one phase, Henry Ford tried it for his motor company ("The Rouge" steel plant remains). Hitler sought it as a goal for the 3rd Reich.

PS-7. Fallacy of Minimizing Costs

The way to minimize costs, literally, is just to go out of business. Something is obviously missing from this standard.

In practice, this false standard means minimizing just selected costs. These days it means downsizing labor force while keeping land and capital idle.

PS-8. Arbitrary assumptions about scale:

Bigger is better, or the reverse, small is beautiful

PS-9. Selective and exclusive emphasis on one side of a tricky optimizing question.

Example: consider how "comprehensively" you should build the parts that fit into a massive, integrated plan (e.g., the California Water Plan).

a. Build total project all at once: achieve economies of synchronizing, integrating, and coordinating the building process, but getting way ahead of demand. (Monument builders and empire-builders fall into this one, usually naming the monuments for themselves and their friends, leaving the costs to the rest of us.)

b. Build capital only as needed: gain economies of synchronizing supply and demand, but ignoring the cost side. Example: to avoid borrowing money, people in Utah used to build a basement with a tempo roof, and live there until they saved enough to finish the house, and had enough children to need the extra rooms.

c. The optimizing solution is "phasing." It is tricky, important, and badly neglected by micro theorists.

PS-10. Fallacy that Maximizing GNP (or local or state, or any gross product) is a normative objective of economic policy.

This belief led Alaska to lease its state-owned oil lands prematurely, turning them over to private people on the cheap, just as they began to rise steeply in value. The oil lobbyists worked hard to nurture the correct viewpoint - for them.

Subfallacy: any resource should be used the moment prices rise, or costs fall, to the point that it becomes supramarginal.

PS-11. Fallacy of Engineering Efficiency, where:

a. Output is measured only in units engineers can observe, excluding other aspects that consumers may value. Example: engineering "needs," as determined by engineers. "Standards," without regard to diminishing returns, or personal tastes or budgets. Engineers are not trained to be modest about imposing their values on others.

b. Input, the same story, e.g. maximizing output/energy. The energy crisis produced a flood of advice along these lines. Much of it added the fallacy of defining energy strictly in physical terms, regardless of quality of fuel, tendency to pollute, cost of use and shipment, etc.

PS-12. Fallacy of Prorating.

a. Managers on economy drives may cut back every enterprise, division or dept. by x% of some input, or total budget, or capital.

b. Cartels that restrict output routinely cut back all members by x% of some basis; or to operate their fixed input just y days/mo.

c. In Utah, in a dry year, all water users are cut back the same % of their base entitlement (the California system is even worse, based on different fallacies).

Results are not "equimarginal"; and usually have strong bias toward substituting land and capital for labor. Cartels force all sellers to carry excess capacity, which screens out lean firms w/o regard to their true efficiency. Water law induces all users to install excess diversion capacity, to build up their claims. Fishing quotas based on size and value of boats have led to there being far more boats than fisheries can support. Etc.

PS-13. Fallacy of Single-valued Priorities.

Example: "I read that oatmeal lowers your blood pressure, so the only crop of real value is oats." Ergo, never let good oat land be used for corn, or vines, or cities, or wildlife habitat, or anything but *oats*. There is only so much Class I soil for growing oats. There is no market for oats, you say? Then save up the land for future oat production.

You think I'm making this up? Try attending a few meetings on land-use planning.

PS-14. Is efficiency uneconomical? Is economizing inefficient? (Recap)

A fallacy of partial economizing is to focus narrowly on Physical Efficiency (e.g. energy-efficiency). Energy conservation is wonderful, but it is not an economic performance standard. It is totally at odds with maximizing labor productivity, for example: you can't have them both. Neither, standing alone, is economical, because it totally overlooks the other. Also, investing more capital to conserve energy is not always the most productive use of the capital, nor the cheapest way to save energy.

a. In PS-1, and PS-2,d, we stressed the folly and fallacy of maximizing AP of VF. True optimizing is maximizing the AP of the *sum* of VF *and* FF, for *total* efficiency.

b. The AP of labor is often loosely called "productivity" and equated with "efficiency." Interfirm, international, and interdivisional comparisons by these measures are common, and fallacious, and harmfully misleading. AP is *partial* efficiency of one input alone, and is maximized only by wasting other inputs.

PS-15. Fallacy of Petty Incrementalism.

This Fallacy bids us consider only minor nibbling at fringes of existing uses, overlooks major changes in uses, quantum leaps of all kinds. It can easily lead us to a low local max on the shoulder of a peak: a "molehill on a mountainside." It is one of the few errors by the estimable Alfred Marshall, whose motto was *Natura non facit saltum* (nature makes no leap). In fact, nature does leap (mutations, eruptions, extinctions, ice ages), and so do mankind, society, and the economy. It was, rather, Marshall who made no leaps - he was a cautious fellow.

We have seen that high-volume land uses (intensive, with high elasticity of production) compete for land with low-volume land uses (extensive, with low elasticity of production) where the low-volume uses yield high rents/worker. The high-volume uses are marginal in those areas, so a small drop in prices relative to variable costs wipes out their rents. Here, adjustments to price changes are not minor marginal changes, but quantum changes in use.

Again, in urban growth there often comes a need to replace a collection of individual systems with one large system, e.g. a mass of septic tanks with a sewer system, or a gaggle of private cars by mass transit. Just prior to the last, improving traffic control is rearranging deck chairs on the Titanic.

The Fallacy of Petty Incrementalism vastly understates supply responses to price and cost changes. A current petty incrementalist in California is Prof. Robert Hagan, UC Davis, who studies the economy of water use and declares that farmers cannot lower their water use by more than 2% without basic changes (which are presumed to be unthinkable). He will consider only incremental changes in current systems, overlooking possibilities of shifting from alfalfa (high water use, low value) to berries, vines, and orchards (low water use, high value); from primitive flood and furrow irrigation to drip irrigation; etc.

PS-16. Fallacy of Free Rent. Examples follow.

a. Timber is financially mature when its growth rate is equal to the interest rate ($F'/F = i$).

b. Dams should be sized so as to max the "benefit/cost ratio." (In practice, the value of the damsite, reservoir site, and the water source, however scarce, are omitted from "cost"). This has resulted in some "pygmy dams" on certain key sites - dams apparently calculated more to seize and hold the sites and power drops than to use them fully.

c. Parking meter fees must be limited to the cost of paying for the meters and meter-maids.

d. Tolls on the Golden Gate Bridge must be set no higher than enough to pay debt service on outstanding bonds.

e. Exxon is more efficient than mom and pop farmers in the hills because Exxon has more sales per worker.

f. It is a senseless waste to tear down a sound structure when it could provide more years of service.

PS-17. Fallacy of Subsidizing what is Largest

Example: "Farming is California's largest industry; therefore we must supply it with cheap water." I am not putting you on: this argument is seriously advanced, and carries weight with many people.

PS-18. Maximizing Mean Annual Increment of Forest Growth

In managing timberland, rotation ages should be chosen so as to maximize mean growth per year, *regardless of cost*.

PS-19. Fallacies of Static Equilibrium

Example: the flow of timber from U.S. forests, and from each particular forest, should be constant in perpetuity (sustained yield). The inventory of timber should never fall below its present level. Timberland should never be used for any other purpose. Etc.

III. Fallacies about Distribution

D-1. Fallacy that we must sacrifice allocative efficiency to achieve distributive equity.

a. Rather, Efficiency is often sacrificed to promote distributive *In*equity. Example: Federal dams in California, Arizona, etc., where the Feds give services and water contracts free or below cost to giant landowners.

b. Some taxes are both progressive *and* efficient, e.g. pollution charges, land taxes, etc.

D-2. Fallacy of Identifying Land with Capital

a. Fallacy that surplus profits are all competed away in a competitive market.

Actually, rents are not competed away. There is nothing about competition that invades land tenures, or produces more land.

b. Fallacy that economic growth solves problems resulting from maldistribution of land.

Nice try, but land is the most maldistributed (concentrated) form of wealth, and land does not grow with economic growth. It just rises in value, worsening class divisions.

c. This writer has detailed eleven or more basic differences of land and capital, in "Land as a Unique Factor of Production," for publication this month.

D-3. Fallacy that *only* win-win exchanges can be shown to raise human welfare (the Pareto Fallacy). Actually:

a. If you can't justify changes because interpersonal comparisons are difficult, then you can't justify keeping things the same, either, for the same reason. Thus, that anti-utilitarian put-off leads nowhere except to confusion.

b. Welfare (probably, usually) rises when A gains more than B loses (unless A is wealthier than B).

c. Welfare rises when A gains what B loses, but it is worth more to A than it was to B [Yes, Virginia, you can make interpersonal comparisons]. This is the "Utilitarian Rule." Property fundamentalists bend every effort to refute and undermine it. This is what Pareto and Edgeworth were up to.

D-4. Fallacies about the Function of Profit.

a. Fallacy that we should produce for use "instead of" profit. [These are often compatible.]

b. Counter-fallacy: producing for profit is always producing for use. [Much profit comes from counterproductive rent-seeking, law-breaking, theft, polluting, etc.]

Synthesis: bad profits stigmatize good ones; good profits camouflage bad ones.

Solution: distinguish good and bad profits, eliminate or tax away the bad ones.

Problem: it is hard to distinguish good and bad; but isn't this what Economists should do for us? What are Economists paid for?

D-5. Fallacy that Entitlements do Not Affect Allocation.

a. According to the Coase Theorem, we should create property rights in pollution (tradable permits to pollute), then let people trade them freely. It doesn't matter who gets the original entitlements, because markets will achieve the same outcome in any case, because your

Willingness-to-pay (WTP) for someone else's entitlement is equal to your Willingness-to-accept (WTA) money for the same permit, should you be the lucky receiver of the original entitlement.[3]

b. Pareto and his followers combine the main fallacy with another, covert supplement: the Fallacy that the Burden of Proof is on those who want change.

The Coasian trick is to put all the burdens on those who would question pollution. The main burdens are two: the burden of buying the entitlement from the polluter (instead of making him buy it from his victims); and the burden of proof.

D-6. Fallacy that property is self-authenticating, an end in itself.

Rather, property needs a higher sanction, a functional rationale.

D-7. Fallacy of identifying (confusing) redistributive gains with net social gains, and vice versa. Examples follow.

a. Farm price support via production control arguments. The argument says that aggregate farm income does not rise as much as the value of marginal output, because everyone's price drops. Therefore, they say, we must stifle output to raise "farm income" (in practice, farm landowners' incomes, not farm workers as such), and everyone's welfare. The fallacy is equating farm income with national or world income, overlooking losses to consumers, employees, tenants, suppliers, et al.

This is a blatant example of abusing the fallacy of composition (see Generic Fallacies). Why? Because this advocate first rebukes others for using the fallacy, but applies it just partially, for the partial gain of farmers over consumers.[4] First he says it is false to say what is good for one farmer is good for all; he says the farmer who takes customers from other farmers is selfish and anti-social. Then he turns around and says "What's good for farmers is good for everyone."

b. Arguments for protective tariff, that ignore the welfare of consumers. Likewise, arguments for free trade that ignore welfare of domestic producers.

c. Blindness to Marginal Cost (MC) pricing.

Wearing blinders, in this case, causes one to identify seller losses with net social losses, ignoring consumer surplus. It takes some careful teaching to keep this blind spot blind.

d. Ellis-Fellner Fallacy, dismissal of external economies, confusing them with monopoly rents. This is pretty tedious stuff, and we probably will not spend time on it.

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[3]Ask yourself, would that make sense for you? Is your WTA = WTP for air quality? Under the current "Reclaim" program in southern California, tradable pollution permits are given to S.C. Edison, Chevron, et al., in proportion to their histories of polluting. Then, to get them to stop, we must buy the permits. What if, instead, you were given a tradable permit that they had to buy from you, to pollute your air? Would you sell it for as little as you can now afford to pay Edison to stop polluting?

[4]How can such obvious bias survive? Many "economists," sad to say, are really hired mouthpieces for special, partial interests. Some so-called scholarly journals are subsidized by such interests. Some universities put pressure on faculty members to support (or at least, not to oppose and expose) State and Federal public works that charge all taxpayers to bring special benefits to the local region. As a result, the literature is full of this kind of thing.

D-8. Fallacy of identifying (confusing) personal distribution and factoral distribution.

a. Fallacy that supply is cut after personal bankruptcy, or other failure. When demand for and prices of a product fall, recent investors on thin equity may suffer personal bankruptcy; but the resources are not destroyed, they just change hands. The creditors can keep the resources producing. They usually do, to minimize their losses. [When they don't, it is often because they are monopolists or speculators: the resources are still there.]

b. Fallacy that profit from land is similar to rent from land.

Actually, a given ground rent is 100% profit to an owner without debt, but yields no net profit to one who is fully mortgaged.[5]

D-9. Fallacy that manual labor is demeaning, undignified. One might quibble that this is an "attitude," rather than a Fallacy, but the effects are the same. This attitude takes many forms.

a. Fallacy that manual labor unfits a person for thinking.

b. Fallacy that performing manual labor is the evidence that a person has failed to make it in the thinking professions.

c. Fallacy that manual labor is a sign of lower caste, hence unworthiness to think or be heeded.

d. Fallacy that labor is surplus, and property owners are doing workers a favor to "give" them jobs.

e. Fallacy that laboring is a sign and result of improvidence, meaning failure to have saved, indicating "lack of character." ["Good character" takes many forms, including willingness to work hard, and use your surplus income or energy to help others - saving isn't everything.]

D-10. There are no net gains in this world, because what one gains, another loses.

D-11. Fallacy of Original Purpose

It is all right for the Federal Government to give away natural resources to selected persons for worthy purposes, e.g. building up the west. But it is wrong and immoral to change:

a. It is wrong to "traffic" in the resources by selling them.

b. It is wrong to convert the resources to some other use than that deemed worthy by a corrupt Congress in 1877.

D-12. Fallacy that Income Distribution and Allocation of Resources are Unrelated

IV. Fallacies about Capital Theory, Finance, etc.

F-1. Fallacy of Abstracting from time.

a. Treating investing in durables as a current expense, see F-5 below.

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[5]Sun World, one of California's largest farm landowners, filed for protection under Chapter 11, 4 October 1994. So did its parent company, Sun World International. It had expanded fast, taken many risks, borrowing to do so. Its major creditor is John Hancock, the insurance company. Chapter 11 means that many growers who market their crops through Sun World may not get paid - they are "creditors," too, although unwilling ones.

b. Fallacy of disappearing inventory, see F-6 below.

c. J.B. Clark and Frank Knight on capital - they denied it has a period of investment, making it just like land. Sadly, much of modern micro incorporates this fallacy, which explains why micro is virtually timeless - it deals with relations of coexistence, ignoring relations of sequence.

d. Confusing supply curves with historical records of supply response: i.e., ignoring that historical response is irreversible, while the "supply curves" of micro are instantaneous.

e. In petroleum engineering, Fallacy of the "Maximum Efficient Rate" of extraction. Here, "efficiency" is given a particular, narrow meaning as the volume of petroleum recovered over time as a fraction of the volume originally in place. It gives no value to recovering it sooner.

F-2. Fallacy of giving capital recovery priority over interest and rent.

Example: calculating "Payback time" as original capital input divided by cash flow (or service flow, or cash savings).

F-3. Fallacy of identifying the carcass with the economic value of capital.

a. Fallacy that Demolishing an old building destroys a lot of capital value.

b. Fallacy that the owner recovers his capital by demolishing the old building. [What she recovers and recycles is the site taken up by the building.]

F-4. Fallacy that Capital is stored-up labor, hence a form of labor. Rather:

a. Capital includes stored-up services of land and earlier capital. Consider, for example, a stand of mature timber.

b. Capital is formed by saving and investing, from any source of income, not just labor.

F-5. Fallacy of treating capital outlays as current expenses.

a. Failing to annualize, thereby overstating Long-run Marginal Costs (LMC).

b. Expensing exploration outlays, on grounds you are replacing reserves just used, barrel for barrel. De facto expensing sneaks in when the outlay comes from profits, and is used to replace something like an old building, an exhausted mine.

c. Fallacy of internalizing company profits, claiming they are not profits but current expenses when reinvested in the firm. Capital thus captured by firm's management often accumulates beyond the firm's capacity to manage productively.

Actually, a proper economic goal is total efficiency. [See under Micro.] This is the same as max *net* product (aka rent) of a fixed input. To see this as a ratio, like efficiency, add the full cost of the fixed input (G) to the cost of the variable input (W), and max P/(G+W). It's really quite simple and basic. It can only be lost when someone is trying to muddy the waters, and others are letting her get away with it.

In this example, "G" is the accumulation of fixed assets added to by plowing back (internalizing) profits. The fallacy comes in when managers treat this money as having no cost, because they needn't pay interest on it.

d. Equating GST or VAT with income tax.

F-6. Fallacy of Disappearing inventory.

The Fallacy is to say that "In a going concern, with normalized (staggered) investments, the lapse of time between investing and liquidating capital is eliminated."

Example: many (like Frank Knight, granddaddy of the virulent Chicago School) say that conclusions drawn from "even-aged models" of, say, forest management, are repealed when the model is "normalized" (one cohort of every age). They say, in effect, that "In a going concern, the lapse of time between investing and liquidating capital is eliminated." This is like saying that when a college balances the outflow of graduates with the inflow of freshmen, students get their degrees the moment they enter college.

Example, the Allowable Cut Effect (ACE) in forest regulation.[6] Under ACE, you get to cut mature timber in return for planting new. Regulating agency considers this to be an equivalent, to conserve stock of timber.

F-7. The Fallacy of "Ripening."

The Fallacy says that the prospect of rising demand, and/or technological advance, bid us defer starting durable structures (and account for idle land in and around cities).

[See Replacement of Individual by Mass Systems for list of related fallacies.]

Actually, it can be shown that the prospect of rising future demand should move an owner to invest in improvements earlier, not later.

F-8. Fallacy that Credit markets tend to shift money from rich lenders to poor borrowers.

Rather, most money runs uphill, from median lenders to wealthy borrowers. This is the effect of credit rationing, especially in bad times, when banks lend only to those with ample collateral. This is how economic power gets so concentrated, and economies of scale are overstated, and diseconomies understated, by so many analysts.

F-9. Fallacy of Overvaluing Mineral Depletion

With oil at $18/bbl, every barrel I take from the ground through my well lowers the value of the reserves by $18.

Corollary: I should be allowed to deduct $18 from my taxable income.

Corollary: every million bbls. of oil reserves should be valued at $18m for loan collateral, property taxation, buying and selling, etc.

Double-think: the industry wants to deduct the $18 from taxable income, all right, but not to pay property taxes on values at that rate, nor to pay capital gains taxes at values that high.

F-10. Fallacy of Subsidizing Risky Ventures

Investors avoid risk. Risk is good. Therefore, we should subsidize risky ventures, provide cheap insurance, tax breaks, etc.

[6]See WTA paper for description.

V. Fallacies in Macroeconomics

Mac-1. Fallacy of Partial Forces Causing General Inflation.

a. Examples: inflation blamed on profiteering; labor union demands; “supply shocks” like overpriced oil imports; world inflation; etc.

Rather, inflation results mainly from misregulation of money supply, resulting in oversupply of money. Rising velocity of money is also a factor. “Fighting inflation” is used mainly as an excuse to hold down wage rates, but also to cap rents, oil prices - whatever is politically vulnerable at the time.

b. Rising employment causes inflation

Doesn’t it make sense that more jobs mean more production? As people go off welfare into production, their output rises more than their spending.

Mac-2. Fallacy of the Immediate Payroll.

Example: fallacy that pouring capital into public works will make jobs. Rather, always demand to know, “Compared to What?” The same capital used in other ways, with faster recovery and reinvestment, will make more jobs.

Mac-3. Fallacy of the Black Hole

This comes from ignoring half of Zero sum transactions.

a. Buying land or other existing asset aborts saving. [The other half is that selling land or other existing asset frees up funds for investing.]

b. Saving lowers aggregate spending. [This black hole used to called the Infinite Liquidity Trap.]

c. Public spending gives the economy net fiscal stimulus (where does the public money come from?).

Mac-4. Fallacy of the Oxymoron

Example: “Unemployment continues to rise, although the recession has ended.”

TO BE EXTENDED

VI. Fallacies in micro and production economics

MIC-1. Fallacy that Pricing is Counterproductive

a. Fallacy that the high price of an input keeps it from use. [This is equating pricing with *over*pricing. There is such a thing as overpricing: sometimes it makes serious problems, e.g. in speculative land markets. Usually, though, in most markets, prices play a constructive rationing role.]

Sub-Fallacy that the high price of an input removes the advantage of using it, so it is used only marginally if at all. [Rather, it drives people to use it sparingly by using it intensively, i.e. combining it with other inputs. A good example is land on The Ginza, 5th Avenue, State Street, and other famous central city hot spots.]

Sub-Fallacy that a high tax-price for holding valuable land will drive it from use (Murray Rothbard). Some compartment-minded, double-thinking folks will see privately-taken rent driving land to its highest and best use, but reverse their story when the rent is taken in the form of a property tax on holding land. Passionate anti-statism (like any other single-valued ideology) leads one into contradictions.

b. Fallacy that the high price of an input is routinely and necessarily passed on to consumers. Rather, it depends on elasticities of supply and demand. Ditto for tax costs.

MIC-2. Fallacy of Melding (Consolidating Accounts, Averaging Costs) to determine regulated prices, power rates, etc.

a. Average-cost pricing, even in simple case.

This fallacy entails:

i. Presuming that AC = MC.

ii. Conceiving "cost" narrowly only as something like burning up or rusting out a material, overlooking that "cost," in the true sense, may mean preempting scarce space or capacity of fixed land and capital (cf. #5).

b. Melding decreasing costs with increasing costs, to hide the former:

Example: Milliman on cost of water supply. Milliman wanted to show that you could price utility services at marginal cost, and still make profits, because (he said) they were in the stage of increasing costs (MC>AC). He said this because to serve more customers you must extend the lines further, ignoring that you can serve more customers inside each perimeter by widening each line.

c. Melding over space

i. Postage-stamp pricing (cf. #6).

ii. Letting rentable resources carry subeconomic operations: cross-subsidy. Example: British Columbia Ferry service to small islands, costing $10 per $1 of revenue, is carried by profits made on the main runs between Vancouver Island and Vancouver City.

d. Melding over time

i. Melding historical with current costs, during inflation. "Historical-cost pricing."

ii. Allocating capital costs, and interest thereon, arbitrarily to specific years, almost always by rote formula not based on actual depreciation paths. This is a kind of melding over time.

e. Regulated pricing by *industry* average costs (cf. #3)

MIC-3. Fallacy of The Representative Firm.

a. Fallacy that the mean or median firm in any sense reacts the way other firms do. This masks vital differences among firms, notably differences between marginal vs. rent-taking firms. There are also differences among divisions and enterprises within firms. It is another error by Alfred Marshall (who is generally a good and useful analyst).

i. Natural gas price control in the U.S.

ii. British Columbia Gas Corporation field pricing.

Foolish plea of FPC economist David Schwartz, “let’s just cut the price so low that we eliminate rent.”

b. Fallacy of representing all sellers as marginal.

No one wants tax-hungry legislators to perceive slack or fat in their part of the private sector, so it is their interest to present a public image of marginality -- the opposite of their image for bankers and stock buyers. Their rhetoric is understandable by putting yourself in their shoes to understand their motives. Remember, though, people who are grinding their own axes often come to believe their own lies, used originally to exploit others. Understand them, yes; but don’t make bad judgments and lose your shirt or waste your vote by actually believing it.

MIC-4. Fallacy that “productivity determines wages.”

a. In its most primitive (and therefore most common) form, the fallacy is one of equating MP and AP. Economic writers, who should know better, do it often, sometimes because they are on someone’s payroll, or hope to be if they work the right side of the street.

b. Actually, the AP of labor is MP/*EP* (where *EP = Labor Elasticity of Production*).

c. From an employer’s viewpoint, with wage rates given, it is actually wage rates that determine marginal productivity. From a total system view they are mutually determined by the interaction of supply (labor) and demand (marginal product).

d. Substituting K for workers raises their AP but lowers their MP (lowers elasticity of production). If substituting is widespread this drives *down* wage rate.

MIC-5. Fallacy of not recognizing preemption as consumption.

a. Fallacy that people should not be charged for using streets because they do not “really” consume them. Here, to “consume” is seen as breaking things into little pieces. This fallacy would make streets a kind of “public good,” a commons of infinite capacity. This makes them like telecasting, with no marginal cost of use. (See also under Taxation, marginal cost pricing.)

Actually, occupying valuable space during a time-slot is how the space is mainly consumed. Paving depreciates with time more than with use; and the right of way does not depreciate at all. Its social cost is purely the cost of preempting its time-slots.

b. Fallacy that holding land is not consuming anything, because the land is not used up or impaired. This attitude would make land be a kind of public good: use by A does not preclude use by B. Rather, preempting land for occupier A keeps its use from all others. Like the lawyer, its time is its stock in trade.

c. Fallacy of Not Recognizing “The Second Law”

The Second Law of Thermodynamics says that adding entropy (chaos, disorganization, adulteration) to a resource is consuming it.

Example: fallacy that only diversions of flowing water (less return flows) are true “consumptive” uses of water (it’s the law!). Rather, loss of elevation and purity both lower value of residual water, consuming its value.

d. Fallacy of Ignoring value of low-cost resources

Example: when oil production is prorated, deeper wells should be allowed to produce more days per month than shallow wells, to recover the costs of the deeper wells.

Example: oil and base prices should be controlled at the cost-of-production at the individual wells. High-cost sources should be allowed higher prices than low-cost sources.

MIC-6. Fallacy of Abstracting from space.

a. Rate regulation with postage-stamp pricing.

b. Overstating economies of scale when this involves "spreading the overhead" of indivisible capital items over more land. The fallacy is to overlook transportation cost of linking the lands. This fallacy is widely committed by farm economists, explaining, for example, the advantages of larger farm buildings and machinery. It is committed by urban economists analyzing the scale economies in a city as a whole, overlooking or trivializing the costs of urban sprawl.

Frequently, too, analysts make it worse yet by overlooking the opportunity cost of the land itself, especially where the alternative use is untenured, e.g. the service of sheltering wild waterfowl. The environmental movement is a reaction against this kind of fallacy. The reaction generates its own fallacies. Economists are inclined to sneer at these, but it is really our fault, for failing to accommodate the environmental values in economic thinking to begin with.

c. Example: measuring the cost of highway usage in ton-miles. In fact, the empty truck uses as much space as the loaded truck.

MIC-7. Fallacy of fixed proportions

The Fallacy: Inputs are always combined in fixed proportions, like chemical valences, for technological or natural reasons. This belief arises from the same mindset that makes demand and supply curves inelastic, and the price mechanism generally irrelevant and delusive.

Rather, the universal rule is that "***Scarcity breeds substitution***." A good manager works with the cheapest suitable inputs suitable to meet demands. History and practice show economic man is flexible and imaginative in adapting over wide ranges. Dimwits say things like "It takes $60,000 of capital to make one job," but assets/worker range from $5,000 (Singer, Mattel) up to $700,000 (Chevron). Examples follow.

a. People who adapt to current prices and costs are accused of abandoning proper "standards," "requirements," "duties," etc. Professional associations (doctors, engineers, labor unions, building inspectors, etc.) are notorious for insisting on rigid standards regardless of cost or demonstrated need.

b. The Charls Walker Fallacy (one of several): national income bears a fixed relation to energy consumption. (Walker is a highly skilled lobbyist and "rainmaker" for foundations engaged in "deep lobbying," tax-exempt. His very job is to promulgate fallacies for his clients, so we find his tracks on several of them.) During the energy crisis, Walker's job was to stampede people into exempting oil firms from taxation. Time has disproven this Walker Fallacy, but he just keeps rolling along, spinning out more.

c. The Fallacy that Farming Requires a Fixed Input of Water.

Actually, water in California yields high returns or low, depending on the crop to which applied: high for tomatoes, low for rice. There is no fixed output per unit.

d. Fallacy that factor proportions remain fixed over the life of durable capital.

Actually, factor proportions change automatically over the life of durable capital. Measuring capital in value terms, a new auto provides capital-intensive transportation; as it ages and requires more maintenance and upkeep and operating care it provides labor-intensive transportation. Ditto for houses and shelter; and if the location rises in value, and the building ages, it becomes land-intensive shelter. All this from the same sticks and stones, over time.

e. Fallacy of Transplanting Technology to regions with different cost patterns.

i. Example: the "Ugly American" syndrome in foreign aid programs.

ii. Related example: the "Edifice Complex" of distant lenders, e.g. The World Bank. This is a virulent complex, not easy to wipe out, because it has been exposed and lampooned and admitted to over many decades. Various Presidents of the World Bank have acknowledged it, and vowed to change - but the World Bank does not change.

"Appropriate Technology" and "Intermediate Technology" and "Soft Path" technology as solutions. Ridicule, marginalization, etc. as counterploys.

If the Bank won't reform, why don't we just stop subsidizing The Bank, then, and let it die? One is drawn to conclude the Bank has another function (promoting private rent-taking, and derivative political conservatism), for which transferring capital is just a cover, and a tool of political persuasion.

iii. Example from earlier times: Americans should adapt the best conserving practices from crowded older countries like Germany, The Netherlands, Belgium, and Japan.

MIC-8. Fallacy of 2-factor substitution

In this Fallacy, the marginal productivity of labor always rises when a firm or economy adds more capital, whether in fixed form like plant/equipment, or working form like energy and raw materials. The Fallacy ignores the substitution of capital for labor; its preachers tell labor it is better off, even though out on the street lining up for soup.

Rather, substituting A for B implies the presence of C: A occupies C and displaces B from its former attachment to C. It's ***The Eternal Triangle of Economics***. This is not a case where "Three's Company."

Most texts are faulty and misleading on this point. They give examples of "substitutability" between K and L. K would truly substitute for L only if it lowered the MP of L, but in most examples in most texts, adding K *raises* the MP of L. That would in fact cause more L to be hired, and the firm to expand.

Here are some examples of true substitution. Farm machinery displaces labor by bumping it off the land; so does capital in other forms like sheep, cattle, timber, bar-code machines, automated controls, etc. So may other natural resources used in fuel, fertilizer, pesticides and water supplies.

Many of these substitutes, in practice, actually lower yields/acre. Such an input is "preemptive." It is nice for landholders who want to cut down their management input: labor is hard to manage. By the same token, they are hard on displaced workers. The modern fallacy of 2-factor substitution could only develop, thrive, and survive in a profession dominated by a wish to keep people from seeing and understanding phenomena like the enclosure movements of the 19th Century, that triggered off the radicalism of both Marx and Henry George.

The productivity of a substituting input is measured in the cost of what it displaces/replaces, less any decline of the Product (and plus any rise of it).

Cobb-Douglas production function is faulty because it contains built-in, unspoken presumption of complementarity between capital and labor: more K always raises MP of labor.

Actually, capital is "Protean" (takes many forms), and changes form each time it turns over and readapts. Some capital substitutes for land and uses labor: e.g. tall buildings, fork-lifts, tomato vines, land-fills, fertilizer, narrow-band broadcasting equipment, theatres, etc. Good land generally complements (makes opportunities for) labor, and substitutes for (obviates) capital. Developing marginal land is capital-using.

MIC-9. Fallacy of exaggerated compensatory effect

Sometimes an analyst will note that a major effect is tempered (muted, or damped) by some compensatory reaction; then take the compensatory reaction for the major effect, forgetting the prime reaction that causes it.

a. The Laffer Fallacy that raising a tax rate lowers the tax base so much it lowers tax take. [This is possible, hence makes a good debating point, but it is rare: Laffer's forecast turned out to be wrong.]

b. A new source of supply (e.g., letting imports into a country) lowers price, which then lowers old sources of supply so much that price rises [Paul Ehrlich, a pessimist who will not be comforted].

c. Higher interest rates lower land rents; the lower land rents make it cheaper to hold standing timber on land, lowering the pressure to cut and liquidate (this fallacy is rare).

MIC-10. Fallacies of historical cost

a. Shrinking the meaning of land rent to mean only returns in excess of normal returns on historical purchase price of land. [Coupled with redefining most labor income as a form of rent, this fallacy completely reverses the classical idea of land rent is peculiarly eligible for heavy taxation.]

b. Arrogating current rent to the credit of current management, by carrying appreciated land at historical cost, instead of marking to market.

MIC-11. Fallacy of automatic, routine pass-through of higher costs and taxes.

In fact, where prices are determined in world or national markets, large local supply changes hardly affect prices at all. Sellers are price-takers, not price-makers. Prices are determined by supply and demand. Costs are only passed through if they cut supply, and demand is inelastic.

How is supply affected? Look at effects on marginal production (intensive and extensive). Low *EP* probably means there is little marginal production (the MP curve falls steeply).

A rise of fixed costs, in fact, may spare marginal production completely, but force better use of fixed inputs. Thus it will actually *raise* production, and lower price.

Higher *variable* costs abort only *marginal* production, and where *EP* is low there is little of that. *EP* is low where rent/worker is high, and here "royalties" based on units of production, and "share-cropping" contracts are common, because their convenience and risk-sharing advantages outweigh their incentive-killing effects.

Here is also where unions can raise wage rates. Low *EP* means a steep MP curve; MP is the demand curve for workers; a steep curve means inelastic demand. Employers with low *EP* may actually favor unions, which hurt their marginal competitors much more than themselves.

Here also is where consumers can capture some rent, by getting legislatures to impose max price controls. Examples: oil and gas; rents in Sta. Monica and N.Y. City.

MIC-12. Sacrificing allocative efficiency to achieve distributive equity, when:

a. Distributive equity is badly defined, e.g. parity for agriculture, helping poor "regions" (with a few rich owners);

b. The policy does not serve the alleged end, e.g. shifting to state sales tax to help poor people; shift to payroll tax to help workers; etc.

c. There are means to attain equity and efficiency jointly.

MIC-13. "First come, first served."

This is how most western water is distributed, resulting in cross-hauling, through a "law of comparative disadvantage": San Francisco goes south for its water, because L.A. might get there first; so L.A. goes north of S.F. for water.

MIC-14. Fallacy of Extending Scale Economies in Production Functions Indefinitely.

Example: the "Six-tenths Rule" of engineering says that Long-run Marginal Cost (LRMC) = .6 x LRAC, in sizing structures, machines, etc. There must be limits to this, but they are not found in The Rule.

MIC-15. Fallacy that Price Controls Always Distort the Allocation of Resources (a Libertarian Fallacy).

If the sellers are already monopolized or cartelized, a price cap might improve things

Where AC-pricing prevails, a cap = MC will improve things (with necessary adjustments, like a flat-rate standby charge, to balance the books)

MIC-16. Fallacy that a monopoly or cartel gains nothing from holding actions, because they must pay the piper tomorrow.

False, because money today is worth more than money tomorrow.

MIC-17. Another Libertarian Fallacy: Street congestion cures itself optimally because drivers avoid congested streets and times.

Likewise, overdraft of aquifers cures itself optimally because as well-water levels sink, pumping costs more.

MIC-18. Fallacy that Uniform Prices are Non-discriminatory

Example: belief that peak-load pricing is an example of price discrimination. In fact, the absence of peak-load pricing discriminates against non-peak customers.

Example: belief that zonal pricing is discriminatory. In fact, uniform pricing is discriminatory, where costs of service are non-uniform.

VII. Fallacies in Public Finance

A. *General*

PF, A-1. Fallacy of hard choices.

a. We must choose between efficiency and equity; inefficiency is the price of egalitarianism. [With landowner subsidies they have it backwards. Allocation and efficiency are sacrificed to promote distributive INequity.]

b. Studiously ignoring available means to achieve equity and efficiency (or growth) jointly.

PF, A-2. Large-group equity

a. Taxing poor people in rich countries to help rich people in poor countries, or regions: interregional equity.

b. Taxing poor people on good land to help rich people owning poor (developmental) land.

c. Taxing poor people in rich cities to help rich farmers. “Parity for farmers.”

d. Help all widows because some are poor and worthy.

PF, A-4. Only win-win exchanges can be shown to raise human welfare. Both parties gain. Otherwise, you cannot justify changing anything because someone may be hurt, and interpersonal comparisons are impossible.

At the same time, you can justify keeping things they way they are, by putting the burden of proof on change. [Actually, if you can’t prove that redistributing wealth will enhance welfare, neither can you prove that keeping it the same maximizes welfare.]

PF, A-5. Analyzing economic concentration in terms of averages, ignoring dispersion.

PF, A-6. Taxes are justified philosophically either by ability-to-pay, or benefits-received.

PF, A-7. Ability-to-pay is synonymous with liquidity.

PF, A-8. All taxes are “*in personam*,” meaning the taxable entity or unit is always some person.

PF, A-9. Fallacy that Public schooling is a “pro-natalist” service which is unfair to childless people and a subsidy to parents with large families.

PF, A-10. It is all right to use public domain without paying a market rent, but it is entirely different, and unethical, to sell that privilege for money.

PF, A-11. Since purchasing power is wrongly distributed, consumer sovereignty leads to a wrong result. Therefore, we should abandon the price system and substitute a rationing system.

PF, A-12. Regression fallacy

a. Horizontal and vertical equity are needed -- each defined in terms of income.

b. The property tax is regressive.

c. An energy tax is regressive.

d. ALL taxes and charges other than income tax are regressive. All taxes are judged by how much they resemble the personal income tax, as idealized.

PF, A-13. Anyone exporting an input (e.g. water) from a source area must compensate all those who were receiving, or might receive, positive externalities (either technological or pecuniary), from its use in the source area. Likewise, anyone importing the input to a target area must compensate all those who receive, or might receive, negative externalities from its use there.

At the same time, those receiving benefits from the move, either in the source or the target area, are receiving what is rightfully theirs as an appurtenance of their property, and have every right to keep it all.

PF, A-15. The income of football quarterbacks is mostly unearned because they were born big and athletic, and have no alternative use worth much. Therefore, we should levy a high tax on persons whom the IRS identifies as having these qualities.

PF, A-16. The value of government to a resident of a country is in proportion to the income he earns there.

B. *Fallacies about overall incentive effects*

PF, B-1. The “income effect of taxation” means that income taxes cause you to work harder. [Always ask, “compared to what?”]

PF, B-2. Lower interest rates cause you to save more, because most people have a target retirement income they must have, regardless of how much they must save to get it.

PF, B-3. It doesn’t matter how you pay taxes, but only how much. A tax is a burden on enterprise and production in any case, and will drive business away (even though all taxes are shifted forward to consumers).

C. *Fallacies about tax incidence, shifting, allocative effects*

PF, C-1. There are too few resources used in monopolized industries, and too many in competitive industries. To redress the balance, we should tax competitive industries more, and monopolies less.

PF, C-2. The best economic use of a resource is that yielding the owner the highest return after taxes.

PF, C-3. All taxes are shifted forward, because prices are determined by cost of production, and taxes are a cost.

PF, C-4. All taxes suppress, destroy and distort incentives, and therefore reduce output. Heavy taxes are always a disincentive to economic activity, growth, and development. We must lower taxes to get and keep jobs, employers, etc. [Solution: distinguish different kinds of taxes.]

PF, C-5.

PF, C-6. The effect of higher taxes is to lower private investors' rates of return after taxes.

PF, C-7. Excise taxes of any kind drive buyers and sellers away from the taxed activity, and thus cause a misallocation of resources. [Not if the taxed activity is harmful and has no buyer, e.g. pollution.]

PF, C-8. Investors may avoid risky ventures. Risky ventures may be very productive. Therefore, Congress should allow special tax concessions for risky ventures. Examples might be lower tax rates, partial exclusion of revenues from taxable income, capital gains treatment of asset sales, and expensing of investments.

PF, C-9. The income tax is neutral because it takes a percentage of net income. The job that pays the most before taxes, also pays the most after. The investment that yields the most before taxes, also yields the most after.

PF, C-10. [Some low-wage workers are kept on part-time, making them officially poor, so they qualify for food stamps, public housing, etc.] This means the taxpayers are subsidizing employers who pay low wages. [Think this one through more! When welfare saves people from seeking work at any wage, it may put a floor under wage rates.]

D. *Fallacies about marginal-cost pricing*

PF, D-1. A street lamp is a pure public good.

PF, D-2. National defense is a pure public good.

PF, D-3. It is wrong to subsidize decreasing-cost operations, because that means taxing other industries and regions.

PF, D-4. There is no way to identify the consumer surplus generated by natural monopolies like distributing water, extending city services, etc.

PF, D-5. To finance a local public work like a toll bridge, you should charge high tolls when it is new and worth a lot, then less as it gets older, more crowded, and less desirable. When the bonds are retired, there is no excuse for charging any toll at all.

PF, D-6. Regulatory fallacies: treated under Industrial Organization rather than Public Finance.

PF, D-7. Fallacy of consolidating accounts (abandoning marginal exactitude).

a. Letting diversified firm (the taxable unit) deduct costs of losers against gains of winners, when undiversified losers cannot do same. Cf. opposition to "safe-harbor leasing," ca. 1980.

PF, D-8. Utilities are monopolies and should be taxed heavily in order to extract the monopoly rents for public use. This lets other taxes be lowered, and is thus a net gain to the people.

PF, D-9. Use of the public streets and roads should always be free: it is a basic human right. This includes bridges, ferries, tunnels, elevators, etc. It is proper to pay for airplane rides and train service, however, because the flying and rolling stock is privately supplied.

People should not be charged for using streets because they do not consume them. Thus, streets are a kind of "public good," like telecasting, with no marginal cost of use.

E. *Fallacies about intertemporal matters*

PF, E-1. The income tax favors investments of shorter payout over longer, because with shorter payout the writeoff is faster, and has a higher present value.

PF, E-2. An income tax taps all sources of consumer purchasing power.

PF, E-3. Treating investing in durables as a current expense.

a. Failing to annualize, thereby overstating LMC.

b. Expensing exploration outlays, on grounds you are replacing reserves just used, barrel for barrel.

c. Writing off cost of tree-planting against stumpage.

PF, E-4. "Fast write-off" of durable capital investments from taxable income has no net effect on tax liability, because you just have to pay tomorrow instead of today. Better pay up early, take your medicine like a man, and get it over with. You'll improve your character, and face the future with a clean slate.

PF, E-5. When oil at the well-head is worth $15/bbl, every barrel I pump from any well lowers the value of my total deposit by $15. I should therefore be allowed to deduct $15 from taxable income, as depletion.

PF, E-6. There is no net income from mining because the resource is exhausted by use.

PF, E-7. Depreciating capital for income tax is biased against longer investments, because the present value of their depreciation allowances is less.

F. *Fallacies about the property tax*

PF, F-1. A lump sum tax would have no marginal disincentive effect. That is, however, purely a theoretical construct with no real-life counterpart.

PF, F-2. If the discount rate is 5%, a property tax of 5% will take the entire income, leaving nothing for the private owner.

PF, F-3. The property tax is minor, because its rate is only 1% in California, while state income tax rates go up to 10% or so.

PF, F-4. A property tax, applied to standing timber, will take more money over the growing period of a tree than the harvest value of the tree.

PF, F-5. A property tax applied to rising, speculative land on the growing urban fringe makes the owners pay a higher share of their income in taxes than other property owners do.

G. *Fallacies about intergovernmental relations*

PF, G-1. Federal grants to local governments are like manna from heaven.