<u>Everyone Needs Economics 101</u>

By Roy Minet (Rev. 01/14/15)

Economics is about money, right? Wrong. Economics is about decision making. Formally, economics is the science and study of how people (individuals and groups) decide to allocate scarce resources to satisfy their wants.

"Resources" might be measured by money, but the decision could just be how to best spend your own time to satisfy your wants. Making such decisions lies at the heart of everything we do from the personal level up through national and world activities. Understanding basic economic laws is crucial to consistently making good decisions. That is why absolutely everyone can benefit from Economics 101 and "the economic way of thinking."

Fundamental economic laws are few in number and not difficult to grasp. Here's one key concept with a couple of conclusions.

There is something that everybody does all day every day which is almost magical, but is not well-understood; it's certainly way underappreciated. In economics, it is called a "voluntary exchange." This is simply an agreement between two individuals (or groups) to swap one thing of value for another. You agree to let your neighbor use your garden tractor in exchange for part of the harvest. Frequently, one side of the voluntary exchange is money; say, you agree to pay $90 for a coat.

The "magical" thing about every *voluntary* exchange is that both parties are guaranteed to come out ahead. You must value the coat at more than $90 or you would not have bought it. The seller must value the coat at less than $90 or it would not have been sold. If any force or coercion is involved, it is no longer guaranteed that both sides gain.

When private property rights are protected, fraud is prosecuted and people are free, they engage in many voluntary exchanges. Billions of such transactions constitute a free market economy. A free market economy arises naturally and spontaneously; it self-organizes.

The large number of exchanges causes the prices of all things to dynamically seek an "equilibrium" that accurately represents the value of every commodity and balances the supply of, and demand for each. This is known as "the price system of resource allocation." It harnesses normal human rational self-interest to maximize creation of wealth; it self-optimizes.

The total cost of any business operating in a free market measures the wealth being consumed by that business. The total sales of the business measure the wealth it produces. If the business produces less wealth than it consumes, it will lose money. It will have to improve its operation or go out of business so remaining resources can be reallocated to more productive uses.

When a business produces more wealth than it consumes, it makes a profit. The profit measures how much new wealth is being created. Therefore, profits are always good for everybody and there is no such thing as "too much profit." Think of Apple which has earned astronomical profits and increased the wealth of millions of customers, employees and owners (shareholders).

Caution: We do not have a pure free market system because of distortions caused by many coercive laws (subsidies, etc.). The use of force may sometimes seem like a good idea, but there are almost inevitably unseen counter-effects that make the overall result worse.

For example, it is impossible to change the so-called "minimum wage." It is always $0.00. If wages greater than zero and less than some arbitrary amount are prohibited, more people will make the true minimum wage because they'll be unemployed.

All economists subscribe to the basic laws of economics. But warning: there is a branch of economics called "macroeconomics" where some economists attempt to understand the extreme complexities of entire economies. Any attempt at greater understanding is laudable, but macroeconomics often relies upon assumptions, complex unproven theories and mathematical models. These guys vehemently disagree among themselves on key issues, yet they still pontificate with apparent certainty. Either you ignore them all or pick one you think *might* be mostly correct!

So, it is basic *micro*economics that can sharpen everyone's thinking and decision making. We should only elect candidates to public office who have earned at least a B+ in Economics 101.

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