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Economic Fallacies and Economic Teaching

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IT IS HIGHLY IMPORTANT in the teaching of economics that students be taught to analyze various widely held fallacies and that they learn how to refute them convincingly. Any teaching which leaves them the easy victims of such (often) plausible fallacies is to that extent inadequate and superficial. Any such teaching is not less—but, rather, all the more—important when some of the fallacies have had the support not only of many of the politically "great" but of well-known professional economists!

Among the fallacies which, in my own teaching, I seek to guard my students against, through explanation, analysis of quotations, general discussion, and written examinations, are the following:

(1) That if workers in a particular line are able, through union control of the number of wage earners in it, to get an increase of wages, the prices of goods will rise not only in this line but also in other lines. In fact, in the absence of increased circulating medium, prices and wages in other lines will tend downward.[1]

(2) That the initiatory force in bringing about business depression is a "state of mind" manifesting itself in "liquidity preference" or a tendency to hold money idle (*i.e.*, a reduced velocity of circulation), rather than a decrease of circulating medium as by sharp and persistent bank credit restriction.[2]

(3) That spending by government for public works can be relied on as an effective way to mitigate unemployment, entirely regardless whether it is new and additional circulating medium which is thus spent, or funds secured through borrowing from or taxing persons who are thus made to spend less in order that government may spend more.[3]

(4) That if other countries depreciate their currency in relation to gold

[1] This is discussed at length in my "Basic Principles of Economics," 2nd edition, Columbia, Mo. (Lucas Brothers), 1947, Chapter V, §5. *Cf.* also, "A Postscript and Questions," Columbia, Mo. (Lucas Brothers), 1946, Part II, Chapter V, §5.

[2] See "Basic Principles of Economics," Chapter VI, p. 129, and "A Postscript and Questions," Part I, pp. 40 and 41. Compare, also, my recent paper in AM. JOUR. ECON. SOCIOL., Vol. VII, No. 2 (April, 1947), entitled "Two Decades of Decadence, in Economic Theorizing," especially pp. 164–5. In this connection, too, I would refer the reader to a communication by Dr. Clark Warburton in *The American Economic Review*, Vol. XXXVIII, No. 1 (March, 1948), entitled "Hansen and Fellner on Full Employment Policies." This, though brief, is an effectively presented challenge and discussion.

[3] "Basic Principles of Economics," pp. 121–2, and "A Postscript and Questions," Part I, pp. 30–32.

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(as by raising an official government price of gold), we must do likewise or have depression and unemployment. In other words, they will "export their unemployment" to us.[4]

(5) That an increase by the United States in the official price of gold, sufficient to prevent the outflow of gold, is the same in its effect on foreign trade as the levy of a protective tariff, *i.e.*, that it similarly reduces international division of labor.[5]

(6) That there is no loss or economic disadvantage in having a huge national debt provided it is domestically held, so that "we owe it to ourselves."[6]

(7) That government borrowing (as by selling its bonds) cannot, according to the condition of bank reserves and whether government does or does not spend the proceeds, either increase *or* decrease the volume of circulating medium and the general level of prices.[7]

(8) That "exploitation" of the workers by "capitalists," by making it "impossible for the workers to buy back what they produce," is the cause of business depression and unemployment.[8]

(9) That the existence of low wages and a "low standard of living" in a country gives it a better chance to produce goods cheaply and thus "undersell" countries with higher standards of living.[9]

(10) That to give certain groups subsidies or tariff favors increases the demand for goods because the favored groups have more to spend, and that thus there is no loss but rather a gain to the groups that are taxed to make the favoritism possible.[10]

(11) That the best system of valuation of public utilities for the purpose of rate regulation is on the basis of "prudent investment," *i.e.*, the amount in dollars "actually, honestly and prudently invested" in the plant at some date in the past and with no allowance for any change either in particular cost prices or in the general price level.[11]

(12) That if inequality is unjustifiably great and thus some have large

[4] "Basic Principles of Economics" p. 116, and especially, "A Postscript and Questions," Part I, pp. 113–4.

[5] "Basic Principles of Economics," pp. 165–6, and "A Postscript and Questions," Part I, pp. 111–2.

[6] "A Postscript and Questions," Part I, pp. 25–6.

[7] "Basic Principles of Economics," pp. 114 and 121–2, and "A Postscript and Questions," Part I, pp. 30–6.

[8] "Basic Principles of Economics," Chapter VI, §7. *Cf.* "A Postscript and Questions," quotations and questions in Chapter VI, §7.

[9] "Basic Principles of Economics," pp. 149–51 and Appendix, §1, and, especially, "A Postscript and Questions," Part II, Chapter VII, §3, numbers 7 and 8.

[10] "Basic Principles of Economics," pp. 167–71.

[11] *Ibid.*, Chapter VIII, §§5 to 10 inclusive.

incomes to which they are not properly entitled while others are poor, a good way to obviate the evil is through a government policy of restricting the production of the things the well-to-do desire and of encouraging relatively the production of the necessities and comforts of the poor.[12]

(13) That the invention and use of labor-saving machinery decreases the opportunities for employment and tends to bring about widespread unemployment.[13]

(14) That the most expensive part of the supply of a commodity can be identified—at least theoretically—as that part produced by the "high-cost firm" or firms; and that the so called "marginal cost curve" of such an individual "high-cost" firm necessarily indicates the price which must be paid to get *that part* of the supply produced. Whereas the truth is that marginal *opportunity cost* is fundamental in the explanation of supply in a way that the so-called marginal cost of the individual firm (really marginal outlay) is not.[14]

(15) That the value of capital is determined only *indirectly* by cost, *i.e.*, that cost of production of any kind of capital determines the amount of it produced, that the amount of it produced determines its yield, and that its yield determines (through the process of capitalizing or discounting) its sale value, and that it is only *through* this indirect process that the cost of production of capital has any causal relation to its value.[15]

(16) That the productiveness of capital affects the rate of interest *only indirectly, i.e*, only *through* its effect on the "time shape of the income stream" or (otherwise expressed) through "over-endowing the future" as compared with the present.[16]

(17) That interest on capital is not earned in the same sense as wages, *viz.*, through contribution by the saver (if he truly earns what he saves) to production, over and above what would be produced in the absence of the capital his saving made possible.[17]

(18) That when tangible capital is taxed, mortgage holders, bond-holders

[12] *Ibid.*, Chapter VIII, pp. 216–7.

[13] *Ibid.*, pp. 258–9, and "A Postscript and Questions," Part II, Chapter XI, §1.

[14] "Basic Principles of Economics," Chapter XI, §§3, 4 and 5 and Appendix, 3; also, "A Postscript and Questions," Part I, pp. 19–20.

[15] "Basic Principles of Economics," Chapter XIII, §§3, 5 and 9 and especially pp. 338–9.

[16] *Ibid.*, Chapter XIII, §§2 to 6 inclusive and 9.

[17] *Ibid.*, Chapter XII, §5, and Chapter XIII, pp. 336–7 and §10.

and other lenders "escape" taxation unless intangibles are also directly taxed.[18]

(19) That the willingness of some wage earners to work for less than labor is worth in a free market, compels other workers to accept equally low wages and so "brings down the whole level of wages."[19]

(20) That there is no distinction significant for economic theory or policy, between capital and land or between the interest yielded by capital and the rent of land.[20]

(21) That the effect of taxing land values is to increase the rent paid by tenants, whereas it definitely tends to reduce rent and to increase wages.[21]

(22) That (within the limit of the amount of revenue either one could yield) a graduated income tax is more favorable to the welfare of wage earners than a tax which would appropriate nearly all of the annual rental value of land.[22]

(23) That although changes in economic policy, including tax policy, which redound to the general advantage are to be desired in other cases, nevertheless an increase in taxes on land values relative to other taxes is ethically indefensible regardless of its beneficence.[23]

(24) That in teaching economics it is just as well to leave out—or to barely mention—the question of who should have to pay whom for *permission* to work and to live on the earth, in those locations where work is relatively effective and where life is not too unpleasant.[24]

Could it possibly be that the younger generation of economists have given their time so completely to the study of bizarre theoretical systems which, though temporarily of the "new look" variety, may soon be—and perhaps already are—"on the way out", while giving inadequate attention to some of the most fundamental principles and most significant problems of economics, that they must be regarded as in considerable degree a "lost generation?"

And might it be, too, that by leaving out, especially, or soft-pedaling, *what is perhaps the most exciting and vital question economists can face*, they necessarily *rob their teaching* of its *greatest and most dramatic appeal* to students?

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[18] *Ibid.*, p. 378 and Appendix, §4.
[19] *Ibid.*, pp. 409–10.
[20] *Ibid.*, pp. 264–5, 276, 310, 351–3, 378 and Chapters XV and XVI.
[21] *Ibid.*, pp. 426 and 474.
[22] *Ibid.*, pp. 426, and 474–84.
[23] *Ibid.*, Chapter XV, §11, and "A Postscript and Questions," Part I, Chapter VII.
[24] See my booklet on "The Teaching of Economics," New York, Robert Schalkenbach Foundation, 1948, especially Chapter V.