Economic Facts and Fallacies

What’s in it for me? Learn to avoid common economic fallacies.

From inequality to urban decay, we face huge crises. They’re all difficult enough to solve on their own, but the task becomes even harder if we misunderstand our problems and get pretty basic facts wrong. Unfortunately, we live in a world where fallacies thrive. And these fallacies can have harmful economic consequences, both nationally and globally. In these blinks, you’ll discover how to avoid fallacious thinking on a whole variety of different subjects. Whether it’s housing policy or wealth inequality, you’ll find out how to spot what the author deems the most common errors. And hopefully, with these errors in check, you’ll begin to think clearly about the problems we all face. In these blinks, you’ll learn

that rent control policies are counter-productive; why the 1929 stock market crash wasn’t so bad; and how urban “improvement” projects get it wrong.

The idea of zero-sum economic outcomes is a fallacy.

Sometimes, politicians and campaigners start out with the best of intentions but end up making things worse. This can happen when their policies are driven by emotions and moral outrage, rather than logic. People cling to mistaken beliefs, and, ultimately, do more harm than good. One such fallacy is the idea that in each economic transaction there must be a winner and a loser. Their exchange is a zero-sum one. In other words, if someone did very well for themselves, it must be at the expense of someone else. The key message here is: The idea of zero-sum economic outcomes is a fallacy. The zero-sum fallacy is at the heart of some well-meaning, but ultimately damaging, economic policies. Take rent control. People who subscribe to the idea of zero-sum transactions think that renting is a transaction in which one side always profits: the property owner. So, they say, there needs to be something that protects the renter. What’s the solution? Rent control. It’s been implemented in the past, and landlords and builders almost always find the terms unacceptable. This means that landlords stop renting, and builders stop building. Eventually, accommodation becomes scarce, and that hurts people who need to rent. For example, when rent controls were implemented by the Australian government after World War II, for years afterward not a single new apartment building was erected in Melbourne! People who subscribe to the zero-sum view of the economy simply cannot see renting as beneficial for both parties. Their actions – as we’ve seen – can be counterproductive. Another area where the zero-sum fallacy appears is international trade. Some believe that the “winners” are invariably rich, highly-developed countries, while the “losers” are poorer and less developed states. They believe that more powerful countries have profited from the vulnerability of their poorer counterparts. But those who believe this are letting sanctimony cloud their judgment. Above all, they’re missing how trade has brought prosperity to many of these poorer countries. Those like South Korea, Hong Kong, and Singapore have only flourished since they opened themselves up to investment from wealthy Western countries. The result was anything but a zero-sum outcome: both parties seem to have done very well from the exchange.

A recurring problem in politics is the post hoc fallacy.

You might have heard of the Latin term post hoc. It comes from the full sentence post hoc ergo propter hoc, which means “After this, therefore because of this.” Or, more simply, since Y followed X, Y must have been caused by X. This is, of course, a fallacy – commonly referred to as the post hoc fallacy. In politics and economics, when you misunderstand basic causality, you risk making terrible decisions. The key message here is: A recurring problem in politics is the post hoc fallacy. There have been some infamous cases of the post hoc fallacy. One involved the pesticide DDT in the middle of the twentieth century. Controversial from the beginning, DDT was eventually banned in the US in 1972. Other governments soon made similar decisions. DDT ended up on the blacklist for a number of reasons, but one argument seemed particularly convincing. It was the widespread belief that DDT caused cancer. At first glance, this seemed to be true. Cancer rates had gone up in areas where DDT had been sprayed. But a closer look revealed this to be – you guessed it – a post hoc fallacy. DDT was often used in poorer countries to kill mosquitoes and reduce the risk of malaria. And it worked: DDT wiped out insects, and cases of malaria declined. People were now living long enough to develop cancer and die of it in later life. So banning the pesticide on the grounds that it caused cancer was a mistake. A costly mistake, in fact. When governments banned DDT, mosquitoes began to multiply. Soon, malaria was killing millions – again. Another example of the post hoc fallacy is the belief that the 1929 stock market crash led to the collapse of the whole US economy and a rise in unemployment. The narrative goes that the big crash led to a deep crisis that lasted for years. But a closer look reveals the truth. A short while after the stock market crash, unemployment actually began to decrease. For jobseekers things only got worse much later: when the government intervened. Policymakers in the US fell for the post hoc fallacy – and made the stock market their scapegoat. The thing is, the truth has a habit of asserting itself. More than half a century later, when the stock market crashed again in 1987, the economy actually grew – against the expectations of many politicians.

The open-ended fallacy is a problem for those with progressive political demands.

Here’s a statement: we should improve healthcare. How many people would disagree? Very few, if any. But let’s take a closer look. What does improving healthcare actually mean? Is it about pouring billions of taxpayers’ money into cancer research? Or spending that same money to fight skin rashes? Suddenly, things aren’t quite so black-and-white. This is the problem with open-ended demands, like “we should improve healthcare.” We only have a limited amount of resources, so we have to specify exactly what we mean and set limits on what we hope to achieve. But many of those on the progressive side of politics fail to do this. They have open-ended demands. They fall for the open-ended fallacy. The key message here is: The open-ended fallacy is a problem for those with progressive political demands. With the open-ended fallacy, you can never finish the job. No matter how much you’ve achieved, you can always do even more. Healthcare can be made even better, streets even safer, air even cleaner. But there’s a danger. Politicians can end up spending enormous amounts of money on only a handful of policy areas. Invariably, governments are drawn to big, emotive subjects that affect lots of people. But this can mean that other fields go neglected. It can also create bigger bureaucracies, all in the name of solving open-ended problems that can never be completely solved. The open-ended fallacy can also take the form of unlimited extrapolation. Take the belief that urban sprawl is unstoppable – more roads, houses, and shops beget even more roads, houses, and shops. It’s often based on the belief that development will be a never-ending cycle. But there’s a fallacy behind this view. The supply of people isn’t unlimited. Every person that moves to a newly-built area reduces the number of people in the place they’ve just left. So, there’s actually no net change in the level of crowding in society as a whole.

The fallacy of composition is something that blights economic policy.

If somebody says to you “The door to the house is made of wood, therefore the whole house must be made of wood,” they’re obviously wrong. It’s what logicians call the fallacy of composition. This is the belief that what’s true of the part is also true of the whole. This is how it plays out in politics: governments support a particular group, city, or industry and expect such steps to improve things for everyone. They pay special attention to the part but they neglect the whole. The key message here is: The fallacy of composition is something that blights economic policy. One example of this fallacy is how local governments look to “revitalize” certain city districts and neighborhoods. They believe that revamping a supposedly “run-down” neighborhood will benefit the whole economy or country. In actual fact, though, they’re committing the fallacy of composition. Here’s what really happens. A neighborhood improves and that draws profitable enterprise and high-income people. They all come from somewhere else, of course, and they push out less successful businesses and poorer residents. None of this offers any net benefit to the economy as a whole. And yet, governments everywhere continue to embark on massive “improvement” projects. On a national level, these accomplish little else than demolishing established neighborhoods, relocating people who have no desire to move, and wasting billions of tax dollars. The fallacy of composition most often involves government spending on certain select projects. The argument is that investment of this sort will benefit the whole economy. Government funds – so the belief goes – will create new jobs and generate tax revenues. So does it mean that governments shouldn’t support any improvement projects at all? Well, the author argues that funds are best left in the hands of taxpayers. They’ll spend their money on what they determine to be important. That’s the best way to avoid the fallacy of composition.

Academic institutions aren’t subject to the same standards and expectations as business.

Imagine a business with a product that’s baffling and useless to most people – let’s say a windup frog that does absolutely nothing. Such a business wouldn’t last very long – in no time at all the company would go bankrupt. But before that moment came, it’s likely that the board of directors and the shareholders would intervene and force the CEO to turn things around. There's a part of the world which doesn't work like that: academia. It's not subject to the same pressures and incentives. And that's a problem. The key message here is: Academic institutions aren't subject to the same standards and expectations as business. In the business world, a company is either profitable or not. If it doesn't offer people something they like, it fails. Shareholders pull out, investment dries up, and the business is no more. This isn't the case with many educational institutions. Unlike businesses, which have to answer to their shareholders and customers, nonprofit organizations, like certain colleges and universities, are mostly unaccountable. This is because they receive money from people whose opinions don't count, like taxpayers, foundations, and donors. In some cases, these donors are long dead and couldn't have a say if they wanted to! Because of this lack of accountability, the author argues, these academic institutions can offer qualifications that are substandard or even useless. Sure, the results of academic research can be useful to society at large. But a good deal of what is generated in academia is only of value to those who pursue academic careers. And as much of this research is subsidized by the government, foundations, and other external sources there are few limits on how far this research can be taken. Research that's no real use to society is allowed to accumulate – and, a lot of the time, all this work just sits on the shelves of university libraries and gathers dust. And what's the use of that?

Statistics can lead to an inaccurate understanding of wealth inequality.

The American satirist and writer Mark Twain said there were three kinds of lies: "Lies, damned lies, and statistics." What exactly did he mean by this? Essentially, statistics can be used to mislead, especially if data is used without context. In politics, statistics are often cited to demonstrate how unequal the world is. But it's not all so black and white. The key message here is: Statistics can lead to an inaccurate understanding of wealth inequality. Wealth inequality is an emotive subject, but stats in isolation don't really tell the whole story. For instance, take the way income is gauged. Most income statistics count income before taxes. But this distorts the picture. After tax, incomes of wealthy people are actually much lower. On the opposite side, these statistics often leave out government support and other similar payments. This means that the actual economic resources of those with lower incomes are often greatly underestimated. Anyone looking at these statistics without the necessary context would conclude that there's a vast difference in the standards of living between the wealthy and the poor. But, in fact, there isn't one. These deceptive statistics can lead to another misunderstanding – that the wealth of the wealthy is derived from the poverty of the poor. When people look at the apparent income gap, they can fall into the zero-sum fallacy that we've discussed earlier. If the wealthy really were benefiting at the expense of the poor, then in a country like the US, where there are more billionaires than anywhere else, ordinary Americans would be some of the most poverty-stricken people in the world. But they're not. The lesson here? Don't take statistics at face value. Don't form an emotive conclusion about how unfair the world is just based on some statistics. Consider the context behind those statistics carefully and let the truth guide you.

The idea that Western nations are to

blame for the poverty of poorer nations is a fallacy.

How Europe Undeveloped Africa is the name of an influential book by the Guyanese historian and activist Walter Rodney. Captured in that title is the idea that Europe exploited Africa – and is, therefore, to blame for the continent's poverty. The idea that rich countries impoverished poorer parts of the world stretches beyond just Africa and Europe. For instance, Indian poverty is blamed on British colonial rule, and troubles in South America are linked to actions of the US and Canada. The author, however, argues that this is a simplistic interpretation of events and that there are other causes of poverty. The key message here is: The idea that Western nations are to blame for the poverty of poorer nations is a fallacy. If the West isn't to blame for impoverishing places like Africa, then what is? According to the author, one of the main culprits is geography. Geography has played an important role in shaping technology and ideas. Many breakthroughs came about through the interplay of different cultures. And the more people interacted with each other, the richer these ideas were. Eventually, this led to prosperity. In the Eurasian landmass, for instance, few geographical obstacles stop people from meeting and exchanging ideas. In centuries past, geography allowed people in Eurasia to develop powerful technologies. On the other hand, in some parts of the world ideas just couldn't be exchanged in the same way. They're cut off from other cultures – by the Sahara Desert, perhaps, or by the great oceans around Australia. And there's also something else. Nations and empires rise and fall. Their standards of living, cultural and technological achievements, even their military powers can flourish and decline. Look at the Islamic world, for instance. For centuries, starting with the Middle Ages, it was ahead of Europe on pretty much every front. It enjoyed a standard of living and sophistication far beyond any country in northern Europe. There has never been "equality" – for all of human history. The nations that enjoy prosperity today could well be poverty-stricken tomorrow. And those that are struggling now might become great empires of the future. There'll be plenty of reasons for these changes of fortune, but one key lesson is to look at the broader picture. Do that, and you might just avoid a common fallacy.

Final summary

The key message in these blinks: There are economic fallacies that occur again and again. From the zero-sum fallacy that tells us that there must always be winners and losers to the fallacy of composition that mistakes the part for the whole, they've blighted economic policy and strategic thinking for decades. These fallacies have put obstacles in the paths of many well-intentioned activists, from environmentalists to anti-poverty campaigners. It's only when these fallacies are dispelled that we can begin to solve the world's problems. Actionable advice: Avoid emotive judgments. The next time you hear something in the news that angers you – whether it's a story about wealth divide or discrimination – take a step back. Check that you aren't letting your emotions cloud your judgment. Are you sure that everything is really as it seems? Do you know all of the details? Does it look like key context is missing? Only form an opinion when you've looked at the situation from all sides.