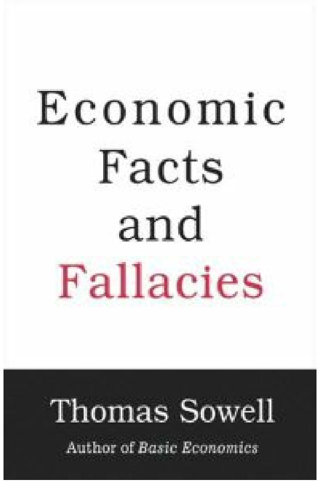

Book Economic Facts and Fallacies

Thomas Sowell
Basic Books, 2007

Recommendation

Long before *Freakonomics* hit the bookstores, Thomas Sowell was popularizing economics in simple plain language. In his latest book, he continues to illuminate the dismal science cheerily, shining his flashlight on a handful of fallacies common to policy makers and even some professional economists. After describing these fallacies, Sowell shows them at work in discussions of urbanization, gender equality, education, income, race and economic development. The result is a bracing tonic that will almost certainly change your views on some of the most emotional issues of the day. *BooksInShort* recommends this slim, fast-moving read to those who are unafraid to subject their convictions to the light of the economic evidence.

Take-Aways

- Popular discussions of economic issues are riddled with fallacious thinking.
- The "fallacy of changing composition" ignores changes among statistical groups.
- The "fallacy of sameness" ignores differences within a statistical group.
- The "zero-sum" fallacy ignores win-win outcomes.
- The "chess-pieces fallacy" assumes leaders can plan and order a society.
- The "open-ended fallacy" extrapolates from limited data.
- Many of the "ills" of urbanization are illusory.
- Male-female pay differences can be explained without pointing to discrimination.
- Income inequality isn't as bad as the media says.
- Racism isn't the primary cause of inequality between racial groups.

Summary

A Fount of Fallacies

In one old joke, two friends are talking on a busy street corner in Manhattan. Noticing the frenetic traffic, one recounts some statistics he just heard. Apparently, he says, a man gets hit by a car in the city every 20 minutes. "Oh dear," says the other friend, "he must get awfully tired of that." Like many jokes, this one contains a subtle truth. That truth, often overlooked in news stories recounting statistical data, is this: Membership in a group (the man) often changes even though the group ("a man") retains the same characteristic.

> "Some things are believed because they are demonstrably true. But many other things are believed because they are consistent with a widely held vision of

> the world – and this vision is accepted as a substitute for facts."

This construct, which might be called the "fallacy of changing composition," is just one of many reasoning patterns that are apt to lead even the cleverest people into mistakes unless they are careful. A related fallacy is the "fallacy of sameness," which assumes that the members of a statistical category are the same in most respects, if not all. For example, generalizing about incomes of 18- to 24-year-old young men is easy. But in this category some are college grads and some are high school dropouts. When considering policy issues, that difference could be crucial.

> "Fallacies are not simply crazy ideas. They are usually both plausible and logical – but with something missing."

While many economic fallacies exist, the most prevalent are the "zero-sum fallacy," the "fallacy of composition," the "chess-pieces fallacy" and the "open-ended fallacy." Taking a minute to understand them can help you see economic issues more clearly.

The zero-sum fallacy goes like this: The assumption is that if one person is made better off, another is made worse off. Sometimes this is the case, but the fallacy lies in thinking that most economic transactions are win-lose. For instance, if developed nations are well off, the theory goes, then this wealth must have come at the expense of less-developed nations. These less-developed nations must have been exploited. Generally, though, free economic transactions are win-win. Both parties benefit. One obvious piece of evidence against the economic zero-sum fallacy is that people continually enter into economic transactions. If one party were always made worse off, you would think people would wise up after a while and economic activity would cease. That, of course, doesn't happen. It is true that the parties in an economic exchange often don't get the perfect deal they wanted, but nonetheless both parties can still benefit.

> "Many desirable things are advocated without regard to the most fundamental fact of economics, that resources are inherently limited and have alternative uses."

The fallacy of composition confuses the attributes of a part with the attributes of the whole entity. Suppose you are in a stadium watching a baseball game. You can't move your seat when you want to see the action more clearly, so you stand. You are better off; other people see you and also stand. Soon everyone in your section is standing, then the whole crowd is on its feet. The result: No one can see any better now than when everyone was seated. Your standing was a zero-sum move: You were better off, but you bought your advantage with others' pain. And all the audience members found themselves in a negative-sum situation, since the group as a whole was worse off, because now everyone had to stand. What was true for you, as a part ("standing will improve my view"), was not true of the whole.

> "Perhaps the biggest fallacy...is the implicit assumption that there is something intellectually baffling or morally wrong about the fact that different nations have different per capita incomes."

Adam Smith spotted the chess-piece fallacy. Smith chastised people who thought they could "arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess board." Yet, more than two centuries after Smith's warning, policy makers still try various forms of "social engineering." Usually such schemes don't work because, unlike rooks and knights, people have wills and desires that often conflict with social engineers' theories. Thus, social experiments tend to have unintended consequences, plus they are expensive and often the people who bear the costs are the very ones the plans sought to help.

> "Questions about the existence, magnitude and consequences of racial discrimination cannot be answered with gross statistics."

The open-ended fallacy has a number of variations, but the common theme among them is simple: a failure to think clearly and concretely about a policy's effects. Sometimes people's thinking about likely results is too rosy. For instance, most people support public health spending. Another dollar for health spending is good, right? Well, not necessarily. Should a society spend half of its GDP to wipe out diaper rash? A quarter? A sixty-fourth? People tend to forget that resources are finite and all choices, including policy choices, require trade-offs. Rash-free skin likely means less of something else, since tax money is finite. Moreover, people often don't think about how long a policy should endure. On the other hand, open-ended thinking is sometimes too pessimistic. Just because, say, a developer has bulldozed some green space in one neighborhood doesn't mean that all of the city's green space is going away. It could be an isolated incident.

> "Some might even say that race itself is a fallacy in a world where racial intermixtures keep increasing...even while the stridency of separate racial identities becomes louder."

If you can spot these fallacies, you'll be well on your way to thinking clearly about some of today's most vexing policy issues. In addition, it helps to be on guard against some of the sloppy thinking that passes for wisdom in discussions of issues related to urbanization, gender, education, income, race and developing countries.

Urbanization

Listening to some people, you might think cities resemble a circle of Dante's hell. Architecture critics complain about "urban sprawl" and how "ugly" today's suburbs look. Rich folks ensconced in fancy suburban mansions complain that developers are ravaging open spaces so they can put up cheap, ugly housing. Social critics complain about a lack of "affordable" housing in the city and point to high-density urban neighborhoods as the cause of crime. Taxpayers resist government efforts to fund new highways, thinking that more roads will only bring in more traffic and hence more congestion. Urban community leaders decry the flight of upwardly mobile workers from the city to the suburbs.

> "In many kinds of endeavors, the costs of not admitting to being wrong are too high to ignore."

While cities and their associated suburbs do have problems, a look at the economics and history of urban development makes them seem far less scary. True, cities tend to be dense. But that is what cities are: They are places where people come together to transact business and create a shared culture. It was always thus. Ancient Rome had about the same number of people that Dallas has today, but the Romans lived on about two percent of the land area. Density doesn't mean things are bad, nor are suburbs evil just because they cover a wide area. After all, people have to live somewhere. Moreover, efforts to restrain growth cause economic distortions. Rich people don't want "cheap" (read small, inexpensive) houses near their neighborhoods. They lobby for restrictive covenants and greenbelts. The result? More costly housing for the middle class.

Gender

The received wisdom is that women have always gotten a raw deal at work. They are unfairly paid less for the same work, says conventional wisdom. Worse, they are subject to pernicious hiring discrimination. Were it not for anti-discrimination laws, common lore insists, women would be in even worse shape, since the patriarchy clearly has conspired to keep them underpaid.

> "Gross income differences between groups can easily lead to fallacious conclusions, if various demographic, educational and other differences are ignored."

Right? Not exactly. Few informed people deny that women earn less than men. They do. The question is why. One explanation is pervasive discrimination and gender bias. But some other explanations are more plausible. Consider this example: According to a study in the *New England Journal of Medicine,* male doctors earn 41% more per year than female doctors. However, the young male doctors in the study worked more than 500 hours a year more than the female doctors When researchers adjusted the two groups for hours, specialty, location and other factors, the income differential disappeared. A female economist's research shed more light on the issue: About 37% of women leave the official workforce at some time in their careers, and about the same percentage work part-time for a while. This pattern shows up repeatedly, suggesting that choice, not discrimination, is responsible for a major portion of the income gap.

Education

To many people, the groves of academe seem idyllic compared to the business world. How wonderful it seems to belong to an institution free of normal business constraints. After all, colleges are nonprofits that are motivated by ideals higher than money.

> "Throughout history, the world has abounded with differences that are today called 'disparities' or 'inequalities,' even in situations where they cannot be explained by discrimination."

Unfortunately, the facts seem determined to deflate such fallacious reveries. Professors often don't have students' best interests at heart. Why should they? After all, once they have tenure, they can't be fired. Moreover, faculty members control most nonprofit universities. Professors sometimes abuse this power, such as when they choose textbooks based on kickbacks they get from publishers. And have you ever wondered why all the "good" classes are held at the same time, in the middle of the day? Possibly it's because those tenured professors want to come to work late and leave early. The result? You can't get the class you want. And even if you got it, you might not learn much. Faculty members generally aren't promoted based on their teaching skills, but rather on their prestige and the research dollars they generate. No for-profit firm could survive were it run like a university. Shareholders would revolt.

Income

Open a newspaper or turn on the TV and you're likely to hear a lot of statistics about U.S. incomes. For instance, the rich are prospering while mid-range incomes stagnate and the middle-class shrinks. The rich get richer as the poor get poorer, and CEOs are shockingly overpaid, given the tiny shareholder value they deliver. Is some, all or none of this correct? Typically, the numbers supporting these claims are based in fact. However, these numbers can be interpreted in wildly different ways, leading to common fallacies. Unfortunately, ideologues on the right and left are apt to give explanations that merely advance their sides of the argument. The media also perpetuate misconceptions. For instance, newspapers like to say that "household incomes" have not risen in the past few decades. That phrase conceals the fact that households have different numbers of members. Without knowing how the size of the average household has varied during that period, drawing reliable conclusions is chancy. Similarly, pundits speak of poor people's "income" without accounting for government transfers, when people in the lowest two deciles of income get more than two-thirds of their income from such transfers.

Race

Few issues are more contentious than race, and few concerns are more subject to confusion. Many feel racism caused slavery, and is the principal cause of today's income differentials between blacks and whites in the U.S. The common wisdom says that discrimination and racism always coincide.

> "Most male-female economic differences are accounted for by factors other than employer discrimination, but that does not mean that there have been no instances of discrimination."

For all these issues and others, walking gingerly through the numbers is the best way to make sense of things. For one thing, using race at all as a classifier can conceal other important group differences, such as age. The median age of African-Americans is five years younger than the general population. Younger people tend to earn less, which helps explain why black people's incomes might be lower.

> "Perhaps most dangerous of all is the practice of not subjecting fashionable beliefs to the test of facts, but instead accepting or rejecting beliefs according to how well they fit some pre-existing vision of the world."

Other racial groups also are much younger than the U.S. median age, particularly Asians (median ages from 23 for Japanese-Americans to 16 for Hmongs), and age "correlates closely with earnings." Racial groups also have different histories. About 60% of Japanese-Americans were born in the U.S., while less than a third of other Asians there were. This can have a huge impact on income and achievement, since native-born workers may be far more familiar with their society than immigrants are. When presented with racial "facts," look closely at the numbers rather than getting stuck on emotional issues.

Developing Countries

Why are some countries so rich and others so poor? Many believe that the answer must be "exploitation." Failing that, perhaps the answer is a lack of foreign aid. If rich countries merely gave more, poor nations could prosper. Right?

> "Some popular fallacies...are centuries old and were refuted centuries ago, even if they are repackaged in up-to-date rhetoric to suit current times."

While this fallacious interpretation is appealing, the reality is different. First, the discussion about rich and poor nations is often cast in terms of the "first" and the "third" worlds. But this is hardly helpful. Countries can be arrayed along a continuum of wealth and little reason exists to think countries should be equally wealthy. After all, countries differ in their geography. Some have rivers that link commercial centers, while others are isolated islands. Some have climates that are hospitable to agriculture, while others are barren and sere. Similarly, countries have different traditions and cultures. Some have a heritage of law and order; others seem prone to lawlessness. Putting such facts together explains a great deal, though it doesn't eliminate these differences.

About the Author

Thomas Sowell is scholar-in-residence at the Hoover Institution at Stanford University. He is also the author of *Basic Economics.*