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Economics for the Citizen, Part 5

by Walter E. Williams

Someone might have made you a gift of this publication. Does that mean reading this article is free? The answer is a big fat no. If you weren't reading the article, you might have watched television, talked to your wife, or worked on your homework. The cost of having or doing something is what had to be sacrificed. While reading this article might have a zero price, it most assuredly doesn't have a zero cost.

To reinforce the idea that price is not the full measure of cost, imagine that you live in St. Louis, Mo. The barber who cuts your hair charges \$20. Suppose I told you that a barber in Charleston, S.C., would charge you \$5 for an identical haircut. Would you consider the Charleston haircut cheaper? While it has a lower price, it has a much greater cost. You'd have to sacrifice much more in terms of time, travel, and other expenses in order to get the Charleston haircut.

People often erroneously think of costs as only material things, but that which is sacrificed when a particular choice is made can include clean air, leisure, morality, tranquility, domestic bliss, safety, or any other thing of value. For example, a possible cost of a night out with the boys might be the sacrifice of domestic bliss.

Costs affect our choices in many ways, and for the purposes of this discussion, we're going to assume that all of the costs associated with a given choice are borne by the chooser.

Just about the most important generalization that we can make about human behavior is that the higher the cost of a particular choice, the less of it will be chosen, and the lower the cost, the more of it will be chosen. This generalization underlies the law of demand. For simplicity, let's assume price measures cost while we hold everything else influencing choice constant.

The law of demand can be expressed several ways: The lower the price of something, the more will be taken, and the opposite is true for the higher price. We can also say there exists a price whereby one can be induced to take more or less of something. Finally, there's an inverse (reverse) relationship between the price of a good and the quantity demanded.

Why do people behave this way? The answer, in a word or two, is that people try to be as happy as they can. For example, if, when the price of oil rises, people simply ignored the price increase, they'd have less to spend on other things and be less happy. If they sought substitutes for the higher-priced oil, they'd have more money left over, and they'd be happier. That's why higher oil prices give people incentive to purchase more insulation, buy better windows, wear sweaters, and maybe move to a warmer climate. These choices, and many more, are substitutes for heating oil, allowing you to use less oil.

When people say a certain amount of one thing or another is an absolute must, that's like saying the law of demand doesn't exist and there are no substitutes. That's untrue — consider a diabetic. Can he do without 50 units of insulin a day? The law of demand says that at some price, say at \$1,000 a unit, he can. There's always at least one substitute for any good, and that's doing without the good altogether. In the diabetic's case, no insulin.

While not having insulin has unpleasant consequences, it's a likely substitute at \$1,000 a unit. You say, "Williams, that kind of economic analysis is cruel!" It's no crueler than the law of gravity that predicts that if you jump off a skyscraper you're going to die. Both outcomes are unattractive, but it's reality. Indeed, tragically, millions of our fellow men around the globe are forced to endure the unpleasant substitute for insulin.

In the next discussion, we'll explore some interesting features of cost, choice, and the law of demand.

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