NOTE ON AN ERROR IN HAZLITT'S ECONOMICS IN ONE LESSON

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Abstract

This book is the best introduction to economics ever written. It has enticed, educated, and inspired multitudes of people to embrace the teachings of the dismal science. To the extent that there is any understanding of economics on the part of the general public, it is due more to this book than to any other. Yet, I have uncovered one error in it, the rectification of which is my attempt to very slightly improve a priceless book on economics.

Key words: Elasticity; Parity Prices; Costs; Profit

JEL Category: D40, F49.

I owe my career in economics to Hazlitt (1946).[1] I use this book in my introductory microeconomics classes, and am very grateful to its author for writing it. Economics in One Lesson is in my opinion the very best introduction to economics, bar none, ever written.

Why then besmirch this magnificent publication with a criticism of it? There are several justifications for so seemingly an unseemly initiative. First, "you can't have too much of the truth." Truth is its own reward. Truth is the byword of our profession, and, indeed, of every profession worthy of the name. If we do not attempt to wield the "terrible swift sword" of truth wherever it leads us, without fear or favor, we are not worthy of the honorific, "economists." Second, from a pragmatic point of view, better that I, a strong supporter of this book[2] call into question one erroneous point made by Hazlitt, the better to very slightly improve the book, than to have a critic of this author's philosophy do so, in an attempt to discredit it. Thus, a benefit of the present criticism is that it might obviate one made with very different motives than those of the present author.

First the background (Hazlitt, p. 91):

> *"The argument for parity prices ran roughly like this. Agriculture is the most basic and important of all industries. It must be preserved at all costs. Moreover, the prosperity of everybody else depends upon the prosperity of the farmer. If he does not have the purchasing power to buy the products of industry, industry languishes. This was the cause of the 1929 collapse, or at least of our failure to recover from it. For the prices of farm products dropped violently, while the prices of industrial products dropped very little. The result was that the farmer could not buy industrial products; the city workers were laid off and could not buy farm products, and the depression spread in ever-widening vicious circles. There was only one cure, and it was simple. Bring back the prices of the farmer's products to a parity with the prices of the things the farmer buys. This parity existed in the*

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[1] All references to this author, unless otherwise specified, will be to this one publication of his.

[2] A vast understatement.

period from 1909 to 1914, when farmers were prosperous. That price relationship must be restored and preserved perpetually."

What, then, is the problematic passage? It occurs as a part of (Hazlitt's, 2008, p. 95) rejection of "parity prices":

"... when the farmer reduces the production of wheat to get parity, he may indeed get a higher price for each bushel, but he produces and sells fewer bushels. The result is that his income does not go up in proportion to his prices."

When price rises and quantity falls, what happens to total revenue? It all depends upon the elasticity of the demand curve between those two points; e.g., the lower the price and the higher the quantity with which we begin, the higher price and lower quantity at which point we end. If the demand curve is inelastic, the farmers' total revenue rises; if unitary, then it remains the same; and if elastic, then it falls, as we move up and to the left along the demand curve.[3]

Suppose the former. We posit, then, that the demand curve is inelastic[4] at its relevant section. The means the revenue accruing to the farmers rises. Does that logically imply that "his income does not go up in proportion to his prices?" Not necessarily. Hazlitt does not take cognizance of the fact that when quantity falls, why then so do costs. This is true, to be sure, not if he burns his crops. Then, costs do not fall, they even rise, since setting them on fire them is not a costless activity. However, if he does not plant these crops in the first place, he saves on land rent,[5] fertilizer, seeds, power for his tractor, etc. *Thus, his costs decrease.* Then, it is possible, given the cost concatenations, contrary to Hazlitt's statement, the indeed farm income "go up in *more than* proportion to his prices."

Let us consider some numerical examples. We will illustrate this point in three ways. First, with a demand curve that is elastic within the bounds we are considering, second, with one that is inelastic, and, third, with one of unitary elasticity.

1. Elastic case

Suppose price rises from 10 to 11, an increase of 10%, while quantity falls from 100 to 90. Total revenue falls from $1000 to $990, and the elasticity between these two points on the demand curve is 21/19, or elastic. In order to have more than a rise of 10% in income, we must go not from $1000 to $990, but, from $1000 to $1100 or more. This would necessitate a cost saving from the decrease in production of anything more than $110. Posit that the cost saving is $120, when quantity decreases from 100 to 90. Then, revenue will increase from $1000 to $1110, a rise of more than 10%. For costs to decrease by $120 when quantity decreases by 10 units (from 100 units to 90 units) the average cost per unit most decrease by $10; i.e., $12/unit. However, if the original price was $10 per unit, the original cost must have been no more than $10/unit, assuming a viable enterprise.

[3] I say all this arguendo, given Barnett and Block, 2010

[4] This assumption flies in the face of standard microeconomic theory. No firm would knowingly operate where demand is inelastic. Thus, if the firm is operating in the elastic range, an increase in price reduces revenue. "Knowingly" is the key word here. Of course "No firm would knowingly operate where demand is inelastic." But, in the real world, firms do this *un*knowingly. And, a full analysis of the economic situation of the world requires that we not ignore this sector of the economy.

[5] Or the opportunity costs thereof

So, even if the firm were operating at breakeven originally and it raised its price to $11/unit, cost must have dropped from $10/unit to -$2/unit for your scenario to work.

Is this logically possible? Yes. Anything that does not constitute a logical contradiction is possible, and this scenario does not constitute a logical contradiction. Is this plausible? Certainly not under the assumption of a "viable enterprise." But not all enterprises are viable. In the real world, which we presume is the one to which Hazlitt addresses himself, there are always some firms making a profit, others breaking even, and still others undergoing losses. Since we are now discussing agriculture, the latter is more likely than in other industries.[6] It is beyond the scope of the present paper to speculate on any such statistics; all we can say for sure is that for some farmers, this numerical example is likely. Hazlitt warns against (1946, pp. 15-16, emphasis added) "… the persistent tendency of men to see only the immediate effects of a given policy, *or its effects only on a special group,* and to neglect to inquire what the long-run effects[7] of that policy will be not only on that *special group,* but on all groups. Farmers who are losing money are a "special group" that we choose not to ignore.

2. Inelastic case[8]

Suppose price rises from 10 to 20, an increase of 100%, while quantity falls from 100 to 90. Total revenue increases from $1000 to $1800, and the elasticity between these

[6] The number of farming firms and the labor force participation in farming has been undergoing a long term downward trend. See on this AP (1988); U.S Census Bureau, 2014, 2019. According to one source: "In the 1800s, 90 percent of the population lived on farms; today it is around one percent." Source: https://www.google.com/search?client=firefox-b-1-d&ei=w13UXdKeLIm WsQX2-YaQBw&q=+farm+population+historical&oq=+farm+population+historical&gs_l=psy-ab.3...4546.4546..6673...0.2..0.84.84.1.....0....1..gws-wiz.....0i71.S-0drB-rvqA&ved=0ahUKEwiSjO-dm_flAhUJS6wKHfa8AXIQ4dUDCAo&uact=5

[7] Elasticities tend to be higher the greater the length of run. That is, there is more of a response in quantity to price changes the more time firms are given to adjust. In the immediate run, quantity is all but fixed, since little or nothing can be changed with notice of only a few seconds, or even minutes. But, as more and more time is allowed, businesses become more flexible. It is not for nothing that major league pitchers hurl the ball toward the batter at speeds of 80 miles per hour or more. They do not want to give the batter time to adjust. When they pitch warmup to their own teammates before the game, the ball comes in at 40 miles per hour or so, and can usually be hit out of the park.

[8] In the view of mainstream economics, in perfectly competitive markets, we can have equilibrium in the inelastic part of demand curve, although each firm sees it as perfectly inelastic. In contrast, a monopolist, or, a cartel which successfully lobbies for restrictions, they will not operate in inelastic part of demand curve, for both revenues increases and costs decreases – and the cartel would reduce the quantity/increase the price. Austrian economists take a very different view of this matter. For the praxeological school, the important distinction is not between number of sellers (one or a few, monopoly, oligopoly; many, perfect competition), but rather whether or not there is freedom of entry (laissez faire capitalism), or restrictions on entry (crony capitalism or economic fascism). For more on this see Anderson, et. al., 2001; Armentano, 1972, 1982, 1989, 1999; Barnett, et. al., 2005, 2007; Block, 1977, 1982, 1994; Block and Barnett, 2009; Boudreaux and DiLorenzo, 1992; Costea, 2003; DiLorenzo, 1996, 1999, 1985; DiLorenzo and High, 1988; Henderson, 2013; High,1984-1985; Hull, 2005; McChesney, 1991; McGee, 1958; Rothbard, 2004; Shugart, 1987; Smith, 1983; Tucker, 1998A, 1998B.

two points on the demand curve is 3/19, or inelastic. In order to have more than a rise of 100% in income, or a doubling, we must go not from $1000 to $1800, but, from $1000 to $2000 or more. This would necessitate a cost saving from the decrease in production of anything more than $200. Posit that the cost saving is $300, when quantity decreases from 100 to 90. Then, revenue will more than double from $1000 to $2100, a rise of more than 100%. In this case MR = +800/-10 = -80 (per unit). Profit maximization (in this case loss minimization) would require MC = -$80/unit. This implies a cost saving of $20/unit when price starts at $10/unit. Again, if we are analyzing the situation of profit earning farmers, or, those breaking even, this scenario must be rejected. But, as Shakespeare informs us: "There are more things in heaven and earth, Horatio, than are dreamt of in your philosophy." In our philosophy, there are also tillers of the soil who undergo losses.

3. Unitary elasticity[9]

Suppose price rises from 10 to 11, an increase of 10%, while quantity falls from 11 to 10. Total revenue remains at $110, and the elasticity between these two points on the demand curve is 1, or elastic. In order to have more than a rise of 10% in income, we must go not from $110 to $110, but, from $110 to $121 or more. This would necessitate a cost saving from the decrease in production of anything more than $11. Posit that the cost saving is $12, when quantity decreases from 11 to 10. Then, revenue will rise from $110 to $122, an increase of more than 10%. To be sure a cost a saving of $12 for a one unit decrease in sales with an original price of $10/unit means operating at a loss, and then having negative marginal cost. But as we have seen, there is nothing implausible, let alone impossible, about such a situation.

This error is no big deal. It is almost, but not quite, comparable to a typographical error. One would imagine that were Hazlitt to read this note, he would quickly acquiesce in the notion that if the cost savings of producing were sufficient enough, then, yes, the farmers' income could indeed rise more than in proportion to the price increase.

Nor is this error based on fallacious considerations such as the Giffen Good.[10] Here, there is nothing as untoward. It is just a simple failure to note that with a lower quantity, it is entirely possible that the costs of production will fall, and by a large enough amount so as to render Hazlitt's conclusion untrue.

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[9] It is said that production can only take place in the elastic section of the demand curve, since marginal revenue will be less than zero in the inelastic section. But this is not quite true. Yes, it is indeed usually the case; but when losses are being registered, this no longer holds. Our economy is one of profits *and* losses, and it ill behooves us to ignore the latter.

[10] See on this Barnett and Block. 2010; Block, 2012; Block and Barnett, 2012; Block and Philbois, 2018; Block and Wysocki, 2018; Klein, unpublished; Klein and Salerno, Unpublished; Murphy, Wutscher and Block, 2010; Wysocki, and Block, 2018.

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