



Embarrassing Economists

So as to give some perspective, I'm going to ask readers for their guesses about human behavior before explaining my embarrassment by some of my fellow economists.

Suppose the prices of ladies jewelry rose by 100 percent. What would you predict would happen to sales? What about a 25 or 50 percent price increase? I'm going to guess that the average person would predict that sales would fall.



Would you make the same prediction about auto sales if cars' prices rose by 100 percent or 25 or 50 percent? Suppose that you're the CEO of General Motors and your sales manager tells you the company could increase auto sales by advertising a 100 percent or 50 percent price increase. I'm guessing that you'd fire the sales manager for both lunacy and incompetency.

Let's try one more. What would you predict would happen to housing sales if prices rose by 50 percent? I'm guessing you'd predict a decline in sales. You say, "OK, Williams, you're really trying our patience with these obvious questions. What's your point?"

It turns out that there's a law in economics known as the first fundamental law of demand, to which there are no known real-world exceptions. The law states that the higher the price of something the less people will take of it and vice versa. Another way of stating this very simple law is: There exists a price whereby people can be induced to take more of something, and there exists a price whereby people will take less of something.

Some people suggest that if the price of something is raised, buyers will take more or the same amount. That's silly because there'd be no limit to the price that sellers would charge. For example, if a grocer knew he would sell more — or the same amount of — milk at \$8 a gallon than at \$4 a gallon, why in the world would he sell it at \$4? Then the question becomes: Why would he sell it at \$8 if people would buy the same amount at a higher price?

There are economists, most notably Nobel Prize-winning economist Paul Krugman, who suggest that the law of demand applies to everything except labor prices (wages) of low-skilled workers. Krugman says that paying fast-food workers \$15 an hour wouldn't cause big companies such as McDonald's to cut jobs. In other words, Krugman argues that raising the minimum wage doesn't change employer behavior.

Before we address Krugman's fallacious argument, think about this: One of Galileo's laws says the influence of gravity on a falling body in a vacuum is to cause it to accelerate at a rate of 32 feet per



Written by [Walter E. Williams](#) on October 22, 2014

second per second. That applies to a falling rock, steel ball or feather. What would you think of the reasoning capacity of a Nobel Prize-winning physicist who'd argue that because human beings are not rocks, steel balls or feathers, Galileo's law of falling bodies doesn't apply to them?

Krugman says that most minimum-wage workers are employed in what he calls non-tradable industries — industries that can't move to China. He says that there are few mechanization opportunities where minimum-wage workers are employed — for example, fast-food restaurants, hotels, etc. That being the case, he contends, seeing as there aren't good substitutes for minimum-wage workers, they won't suffer unemployment from increases in the minimum wage. In other words, the law of demand doesn't apply to them.

Let's look at some of the history of some of Krugman's non-tradable industries. During the 1940s and '50s, there were very few self-serve gasoline stations. There were also theater ushers to show patrons to their seats. In 1900, 41 percent of the U.S. labor force was employed in agriculture. Now most gas stations are self-serve. Theater ushers disappeared. And only 2 percent of today's labor force works in agricultural jobs. There are many other examples of buyers of labor services seeking and ultimately finding substitutes when labor prices rise. It's economic malpractice for economists to suggest that they don't.

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