

# *The* POWER *of* SUPPLY *and* DEMAND

*Thinking Tools and Case Studies for Students and Professionals*

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香港大學出版社

HONG KONG UNIVERSITY PRESS

Hong Kong University Press  
The University of Hong Kong  
Pokfulam Road  
Hong Kong  
[www.hkupress.org](http://www.hkupress.org)

© Hong Kong University Press 2003  
First published 2003  
Reprinted with amendments 2006

ISBN 978-962-209-569-4 (*Paperback*)

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British Library Cataloguing-in-Publication Data  
A catalogue record for this book is available from the British Library.

10 9 8 7 6 5 4 3 2

Printed and bound by Hetermedia Services Ltd. in Hong Kong, China

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# 1 The Reasons for and Concept of Economics

Open your eyes and see how beautiful the world is, and how lucky we are who are alive! (Popper 1999: 198)

. . . What did we bring into the world? Nothing! What can we take out of the world? Nothing! So then, if we have food and clothes, that should be enough for us. But those who want to get rich fall into temptation and are caught in the trap of many foolish and harmful desires. . . For the love of money is a source of all evils. . . (1 Timothy 6: 6)

Keep your lives free from the love of money, and be satisfied with what you have. (Hebrews 13: 5)

We shall begin this book by discussing the social status of economics, the motivations for learning economics, some misconceptions about economic inquiry, the scientific nature of economics, and the relevance of constraints to economic analysis.

## The Status of Economics

Economics is a worldly philosophy, a philosophy for the City of Man. This worldly philosophy, once described as a dismal science by Thomas Malthus, is now regarded as the 'Queen of the Social Sciences'. It is the only social-science discipline that attracts a Nobel Prize, the 'Prize in Economic Science in Memory of Alfred Nobel'. A social science is an empiricist discipline that attempts to apply the methodology of physical science to the investigation of phenomena in human social existence. In universities, aside from the economics departments, economics is also offered by professional degree courses that follow a multi-disciplinary approach. These courses include business, purchasing and supply, management, surveying, town planning



and some accounting curricula. In some American and Australian universities, double economics and law degrees are a popular choice for students. In high schools, economics is also a subject of growing significance and popularity.

## The Incentive for Learning Economics

People study economics for various reasons. The really dismal reason is that there is no other choice because it is a mandatory subject in acquiring certain academic or professional qualifications. This reason aside, there are three popular reasons for learning economics formally:

1. To acquire knowledge for the purposes of earning more income — the *money-making* thesis (say, by speculating successfully in the stock and real estate markets).
2. To develop the means to improve society — the *policy* or *social-reform* thesis (say, to foster economic growth; to tackle unemployment; to fight inflation; or to devise policies that can render resource allocation more efficient or wealth distribution more equitable).
3. To develop a systematic way of understanding and predicting human behaviour — the *scientific* thesis

The domains of the social-reform and scientific theses fall respectively into the ambit of 'normative economics' and 'positive economics'.

Those who subscribe to the money-making or social-reform theses may become highly disillusioned as a result of learning economics formally. Although there are economic courses that deal with investment decision making, a degree in economics does not necessarily enable one to make the most profitable decision in any specific business or speculative activity. Profits, indeed, are unexpected or unplanned income. Possessing more knowledge about the consequence of investment does not necessarily make one a better investor. Personal success often depends more on family history, endowment, social skills, general education level, chance, or even luck rather than theoretical knowledge in economic theories *per se*. Furthermore, the acquisition of knowledge or formal university training in economics or a career in the same field may be realized only at the considerable cost of foregoing more lucrative alternatives. Two Hong Kong examples serve to illustrate this point. The first example is that a Hong Kong University surveying graduate with a professional degree may, by the age of 24 or thereabouts, be

able to earn as a pensionable surveyor in government the income of a local university lecturer in economics. If this graduate chooses to follow an academic career teaching urban economics, the extra time cost is huge. He or she may have to undertake a further five to six years' doctoral study in a reputable overseas university and publish a number of articles in leading academic journals before becoming appointable as an assistant professor in a local university. The appointment may only earn the same starting income (with a much shortened career ladder) of his or her classmates who choose to work as practitioners upon graduation. Even if the appointment is made initially without higher qualifications or publications, the graduate will be under great pressure to acquire or produce them for contract renewal or substantiation of appointment. The extra investment in human capital and intellectual effort of the graduate who aspires to become an academic are not justified if money return is the sole concern. The second example has more to do with the condition of the economy. In the 1980s and 1990s, when property prices in Hong Kong were soaring, the average monthly income of an ordinary real estate agent could be several times the annual income of a teacher in economics.

For those who may be social-reform motivated, the international experience of post-war economic management in both the Western world and in the socialist bloc does not suggest that heavier social investment in the education of economics or economic management necessarily leads to better national economic performance. Yet, people have high regard for the social use of economics. The role of ideas in influencing policies has always been accepted as being essential in making strategic management or planning decisions. Why? We believe economics does provide a tool for people to engage in rational discourse. Although notorious in the accuracy of predictions, money-making and social-reform theses for learning economics certainly remain convincing to many people without formal training in economics. The social-reform agenda of economics is indeed adopted by many professional economists. This is so notwithstanding the painful fact that (a) politicians may not always adopt their proposals, and (b) even where their proposals are chosen as policies, the espoused aims of these policies may not be achieved for all kinds of reasons.

The scientific thesis for learning economics, while being not necessarily mutually exclusive with the other two theses, is the purist academic reason for studying human behaviour. It is indeed the common ground of all empirical

social science disciplines. The champion for this thesis often argues that the economist should not bother with improving society. While it is unlikely that the economist can 'save the world' by offering good policy advice, those who support the social-reform thesis often raise this difficult question for the supporter of the scientific thesis. Why should government sponsor academics to engage in purely scientific research that has no policy relevance? The standard answer of the holder of the scientific thesis is that it is one thing to prescribe policies for achieving specific goals, it is another thing to evaluate whether these prescriptions are feasible or acceptable to those with authority. The distinction and relationship between 'normative' and 'positive' economics belies the discussion of this question. Note that many famous economists who adopt the scientific approach have, from time to time, evaluated policies from their value positions and offered policy proposals that are welcome by policy makers. On the other hand, there are policy makers who rationalize their decisions after the fact, as illustrated in the autobiographies of many famous people.

The focus of this book is to use economics as a way to understand and to analyze policies. By doing so, we may also be interested in understanding human behaviour under various constraints, the emergence and the choice of dealing with the constraints. Whether such an understanding should be an end in itself or a means to accumulate more personal wealth or develop policies to improve society is ultimately a choice for the individual reader.

## **Contentious Arguments About Economics**

Economics is an open access discipline in the sense that there is no need to obtain a professional qualification or licence before one may claim to be an economist or say anything about economics or discuss economic issues. Nor are there any self-imposed restrictions laid down by economists, unlike architects in Hong Kong, to prohibit criticism of each other's opinions or output. Trained economists do have the means to rank themselves against each other and sophisticated methods have been devised to regulate competition for positions and prizes. However, there is no law prohibiting people from saying things about economics. Within this context, the beginner in economics is often confused by a number of popular contentions about economics or about some economic ideas and theories. Such contentions stem largely from misconceptions. The 'lay person' is not to blame, as

professional economists themselves have no consensus and are often the champions or victims of these erroneous concepts. The term 'professional economist' usually refers to academics or practitioners in business or government who have formal educational qualifications in a broad subject area known as 'economics' and are paid as such. George Stigler has said that economists are preachers of their beliefs. Obviously, they have not preached well.

The term 'lay person' in economics must be clarified. Lay persons could well be experts in other professional fields such as medicine, law, planning, biology, environmental protection, surveying, education, engineering, transport, architecture, management, social work, investment and so on. By virtue of their daily experience or professional practice, these experts are certainly aware of a corpus of key economic terms. These terms include profit, market, perfect market, plan, government, supply, demand, competition, perfect competition, economy, microeconomics, macroeconomics, and so on. Indeed, they may well have developed highly sophisticated concepts about or even established a legal monopoly in defining these terms. Lawyers, in particular, are excellent at doing so. Examples are the rules of 'professional ethics' they erect to regulate entry and competition of foreign lawyers and competition (or 'practice promotion') among themselves. The knowledge of or power over terminology, however, does not necessarily imply or require any understanding of terminology in a scientific or analytical sense. A word of warning here: semi-familiarity with logic can be misleading; and the use of authority stamped and approved by professional bodies may not alter reality.

In the following, we shall list and discuss, in descending (ascending) order of importance to the lay person (the professional economist), ten common contentious concepts about the nature of economic inquiry.

1. Private interest and public interest are always contradictory (the public-interest argument).
2. Economics is but one consideration in decision making (the comprehensive-assessment argument).
3. The market and the plan (or 'planning') are different (the plan-market dichotomy/argument).
4. The market only works under conditions of perfect competition (the perfect-competition argument).
5. Microeconomics provides an incomplete view of the economy (the macro-analysis argument).

6. Economic theories are doubtful as they are predicated on wrong or unrealistic assumptions (the artificial-assumption argument).
7. Economic theories are too abstract to be of any practical purpose, for which we need 'facts', not 'theories' and practical actions (the theory-and-fact or theory-and-practice dichotomy/argument).
8. Economics is a money fetish (the money-fetish argument).
9. Economics is a materialist discipline (the hedonism argument).
10. Individuals make rational economic and social choices only through the market (the economics-as-market-transactions-only argument).

The first argument, the public-interest argument, is often shared by those who subscribe to both the money-making and social-reform theses at the same time. In their thinking, money-making is a self-regarding activity whereas social reform is other-regarding activity for 'society'. They also believe that there is always an inevitable and irreconcilable contradiction between self interest and collective interest. They do not accept the central concept of libertarian economics, ascribed to Adam Smith, the founder of modern economics, and now most frequently associated with Friedrich von Hayek and Milton Friedman. The concept of the libertarian economist is that the dichotomy between individual and social or public interest is a false one. According to the ideal of the libertarian economist, collective benefits will naturally arise where individuals are permitted the maximum freedom to pursue their self-interest, through the freedom of contract or 'the invisible hand of the market'. Collective misery, famine and even war may follow if such pursuit of interest or the freedom of contract is artificially restrained by the visible hand of the state. Collective interest is, from the libertarian's point of view, nothing more than the sum of private interest. Rampant starvation and waste of human lives in Nazist and communist regimes and the failure of socialism in practice in the last century, particularly the collapse of the Soviet Union, have given the libertarian economist a powerful argument against state encroachment on economic affairs. The mere abolition of central economic planning by ex-socialist countries, however, does not always guarantee economic revival. The qualifying view is that whether laissez-faire economic policies do result in improved collective welfare depends on the existence of a host of preconditions or constraints. These caveats were implicit in the writing of Hayek and Friedman, often cited as the proponents of markets. Joining forces with these intellectual giants, Steven N.S. Cheung, a

Western-trained Chinese economist, argued that these preconditions are private property rights and the rule of law. The rule of law includes equal human rights. The welfare economist, developing the ideas of Arthur Pigou enunciated in the book *Welfare Economics*, does not agree with the libertarian economist and provides an elaborate theoretical account of the discrepancy between private cost and social cost, private benefit and public benefit. This discrepancy is a kind of 'market failure', a paradigm invented by the welfare economist, the follower of Pigou. To remove this kind of discrepancy, government or state intervention is justified, argues the welfare economist. The very existence of such a discrepancy, and the need for government intervention, has been challenged by the so-called 'Coase Theorem' advanced by Ronald Coase in his paper 'The Problem of Social Cost'. We shall discuss the Coase Theorem in the last two chapters of this book (Chapters 11 and 12).

The second argument, the comprehensive-assessment argument, follows from the dichotomy between 'economic' and 'non-economic' decisions and the belief that, the former, if at all relevant, is subsidiary to the latter. This dichotomy is often coupled with the unnecessarily restrictive view that economics consists merely of private profit making and financial considerations. Examples of 'non-economic' considerations advanced by critics of libertarian economics can be found in regulatory decision making in government town planning. They include 'planning considerations', 'social considerations', 'environmental considerations', and so on. While these terms may or may not be meaningful concepts in articulating normative issues in planning, these critics often refuse to relate such concept to economic thinking. When interpreting others' behaviour, these critics refuse to acknowledge the general nature of decision making as one of making choices under constraints. To them, policy is a matter of persuasion or directive rather than a matter of reasoning. As a result, policies often would be merely statements of what the authority wants to do.

As the Chinese saying goes, "for every policy above, there are individual decisions below." We hold that economic decisions are outcomes of constrained choice and have actual consequences, irrespective of the normative nature of the constraints considered or teleological decisions taken. To assert that economics is but one consideration often indicates attempts to conceal relevant objective constraints of, or impacts upon, private property rights. While such neglect may be conceptual, it may also be self-serving.

Government planners shy away from private property rights, which their decisions often invade. To argue that a certain planning policy or law is chosen in favour of 'environmental' or 'planning' considerations notwithstanding 'economic consequences' may be in itself a kind of economic decision. The reality is that, whether we acknowledge or like it or not, the choice of accepting one set of considerations incurs the cost of foregoing its alternatives. Many so-called 'non-economic' decisions are indeed well-calculated choices made within the institutional setting of the decision-making body. The study of such choices falls into the arena of the public-choice approach to institutional economics. In any event, whatever categories of relevant 'considerations' are taken into account, a policy decision often has objective resource-allocation implications. That a policy or piece of legislation is based on a host of considerations other than 'economic' ones does not mean that its economic consequences can be or should be ignored. To ignore economic consequences is an extremely reckless and sometimes hardly politically justifiable decision.

The third argument, the plan-market dichotomy, is a false dichotomy. A business firm makes plans. An individual makes plans. The so-called market-plan dichotomy is really one between 'private planning' and 'government planning', the distinction being who is making the decision. This point is clearly explained by Thomas Sowell, who argues that government planning often means the 'forcible replacement of private planning by government officials'. Two interesting questions are: (a) why should we allow the decisions of the government planner to take precedence over those of the private decision-maker; and (b) how can we measure the performance of the government planner? While the answers of the welfare economist and the institutional economist to these questions may be far apart, there is no question that they are meaningful issues for the public.

The fourth argument, the perfect-competition argument, is likely to be a legacy of the residual memory of the term 'perfect competition' in economic textbooks. Perfect competition generally refers to a scenario in which information is 'perfect', the cost of entry/exit is zero, and that the nature of a product is homogenous. Perfect competition is just an ideal case that serves mainly as a starting point for analysis. Those who share this misconception tend to think that the price mechanism does not work well unless the 'market structure' or 'industrial structure' is one of perfect competition. A lengthy exposition is required to discuss this view fully. Suffice to say that the 'law of demand' does apply in all types of market structure, be they perfectly

competitive, monopolistic, oligopolistic or monopolized. [Note that the Coase Theorem has also been said to be useless unless there is perfect competition. The Coase Theorem can be criticized for including the redundant assumption of zero transaction costs at the same time the notion of property rights is used. However, most criticisms of Coase's ideas leave one wondering whether the critics have read 'The problem of social cost' carefully or at all. The Coase Theorem refers to the notion that if property rights are clearly delineated and if all costs of transactions are zero, then resource use will be the same regardless of who own the property rights (or regardless of the pattern of rights and liabilities assignment). While many commentators are correct to say that the condition of zero transaction costs is also the condition of perfect competition, it is wrong to suppose that the absence of this theoretical condition implies that the theorem has no meaningful implications. Quite the contrary, the most powerful implication of the Coase Theorem is indeed its corollary where transaction costs or market imperfections abound. This will be fully discussed in Chapter 11.]

The fifth argument, that policies need to be macro-analyzed, believes that the scope of such analyzes are independent of the laws of supply and demand or has no 'micro' foundation. The quest for the idea of 'a complete view' of the economy should not lead one to ignore supply and demand conditions of specific trades or policies. We shall examine some vital elements and tools of microeconomics later in this book.

The sixth argument, the artificial-assumption argument, has led to protracted debate in the philosophy of social sciences. Theories as conceptual entities are, of course, unreal. Where assumptions are unreal or even false, the power of theories predicated on these assumptions may still be great. There is simply no logical relationship between the truth of assumptions and the validity of theories based on them. As explained by Ernst Nagel, to argue that theories are wrong because their assumptions are wrong is to commit the so-called 'fallacy of denying the antecedent'. Economists such as Friedman simply do not care whether theories are realistic but only that they can result in testable prepositions. These pragmatic economists are called 'instrumentalists'. Having said that, it is also true that there are many more economists who would like their theories to be both realistic in assumptions as well as useful in predictions.

The seventh argument, the theory-and-practice dichotomy, is that theories as conceptual entities are artificial and have hence no practical use. A good



interpretation of this argument is the message of Albert Einstein to another Nobel Prize Laureate, Werner Heisenberg: 'It is theory which decides what we can observe.' This message is made competently by Charles Cole and Willima Baumol in explaining the relationship between theory and practice in their text *Microeconomics: A Contemporary Approach*. Indeed the relevant question to ask is whether theory can indeed assist practice beyond a mere scientific inquiry to satisfy intellectual curiosity. On this issue, our feeling is that the use of theory probably contributes to at most 20% of a decision-making process. The remaining 80% stems from a knowledge of industry and human specificities, sensitivities to issues and responses, the mastery of methods of communication, skills in articulation, and so on. We cannot live without economic theory, but we cannot depend on it solely either!

The eighth argument, the money-fetish argument, is typical of the teaching of some economists who follow the ideas of Karl Marx. They hold that economics is a false ideology with the circulation of money and goods as the subject matter. However, we should note that the general focus of economics, or price theory at least, is human choice subject to constraints. While it is true that the constraint adopted to analyse human behaviour is often the money (budget) constraint, the approach does not preclude the use of other constraints. Indeed, Marxian and economic theorisation are similar — albeit the former adopts class relations as the predominant constraint on behaviour. Money is indeed just one of the many subjects of enquiry.

The ninth argument, the hedonism argument, is largely the result of an empiricist methodology of economic inquiry. It is affiliated to the money-making thesis discussed above. The assumption of human selfishness in behaviour modelling, the subject of the next chapter (Chapter 2), also contributes to this view about economists. Whether economists are atheists or agnostics is irrelevant. The question is whether the subject teaches people to be materialistic, greedy or to reject religions. On this issue, economics as a decision science does require actions to be justified on the basis of gains and costs. But it is entirely up to a decision-maker to define what the gains and the costs are, including altruistic reasons. A deeper view of the problem is that economics is a naturalist discipline. And one could even argue that there are some fundamental moral norms underlying many economic phenomena and institutions, if moral norms are not themselves outcomes of economic decisions. At the social level, the moral concept of honouring one's promise

is the pillar of self-enforcing trade practice as well as contractarian political theory. At the personal level, an awareness of one's own selfish inclinations could be morally beneficial in guiding one's behaviour or examining one's motives for action. However, we shall not deal with the conflicts between morality or religion and economic theory in this book. This is not the same as to say that morality or religion is not important.

The tenth argument, the economics-as-market-transactions-only argument, is that economics deals only with choice making in the market. This is entirely wrong. Economists deal with choice making under specific constraints. The market is but one set of constraints, which depends on commercial laws and private property rights. We shall deal with constraints and private property rights in the following chapters (Chapters 2 and 3). However, there are many choices made outside the market. Transactions in politics, in offices, in clubs, in schools, in families, and between friends involve choice making in settings that we normally do not regard as 'markets'. Yet such choice making can be meaningfully examined with the help of economic theories. Even in socialist regimes where the market is suppressed by law and policy, the behaviour of individuals is still predictable using basic economic concepts. We study a few hypothetical examples below in relation to the verifiability of economic theories.

In a later chapter (Chapter 4), we examine nine arguments against free trade, which are often mistakenly and confusingly regarded as arguments against the discipline of economics itself.

## Verification of Economic Theories

Whether the social sciences can attain the same status as physical sciences in predicting events has haunted the minds of the philosophers of social science. Those who are keen on learning economics must appreciate the major methodological issues involved. One major issue is whether it is at all possible or ethical to conduct economic experiments on human beings or society. A few economists do use the methods of experimental psychologists to 'test' people's behaviour in the laboratory or under controlled conditions in terms of economic theory. Vernon Smith's experimental economics and Mancur Olson's group theory are a few examples. However, many economists also believe that such artificial experiments have little practical or theoretical value. Having said that, economists do consider that the economy and history do

reveal regularities, the focus of scientific inquiry. Douglass North and Mancur Olson have offered theories of Western history based on economic analysis of regularities in the rise and fall of institutions before the twentieth century. Their analysis would be much more convincing if it were to more boldly interpret events in the twentieth century preceding the rise of China and the collapse of the Soviet Union. Twentieth-century history indeed provides the economist with examples of real life experiments conducted consciously and deliberately on a massive scale. Experiments with socialist modes of ownership according to the nineteenth-century 'dialectic materialism' teaching of Marx and central economic planning under a dictatorial party were conducted in the Soviet Union and the People's Republic of China, countries with huge cultural and historical differences. The Soviet Union as a military superpower has withered away peacefully partly due to internal economic failure. During the Cold War, most social scientists had anticipated that a superpower would be destroyed only by a nuclear war. In this period of covert war, a contractarian view of ideology and economic system was not accepted by the die-hard followers of Marx. In the wake of the reforms of Deng Xiaoping in China, Steven N.S. Cheung bravely predicted in his monograph *Will China Go Capitalist?* that China would adopt a market economy in place of planned economy. The Chinese economic reform initiated by Deng is really exciting and provides a testing ground for the predictive power of many standard economic theories.

### **Influence of Constraints and Incentives on Behaviour**

. . . can it perhaps be said that, after the failure of communism, capitalism is the victorious social system, and that capitalism should be the goal of the countries now making efforts to rebuild their economy and society? . . .

The answer is obviously complex. If by 'capitalism' is meant an economic system which recognizes the fundamental and positive role of business, the market, private property and the resulting responsibility for the means of production, as well as free human creativity in the economic sector, then the answer is certainly in the affirmative, even though it would perhaps be more appropriate to speak of a 'business economy', 'market economy' or simply 'free economy'. (*Centesimus Annus 1991*, para.42, pp. 81-82)

Consider the following well-known stories that have arisen from the Chinese economic reform: (a) In the heyday of the Gang of Four, Mr Chan was a member of a production team in the Pearl River Delta, China. He had a two-hour nap after lunch and appeared to be quite unproductive. After he had swum to British Hong Kong prior to 1978, he behaved differently. He worked 14 hours a day and was so entrepreneurial that he has become an employer and a property owner in Hong Kong. (b) Mr Lee was a comrade of Chan who did not choose to swim to Hong Kong, either out of laziness or patriotic loyalty to his mother country. He could personally benefit from the old regime, as he could have a three-hour nap after lunch. However, after he had entered into a 'responsibility contract' after the introduction of Deng's economic reforms, he slept very little and worked so hard that he eventually became one of the wealthiest persons in the village.

The above stories reveal the significance of the changes in the economic system or institutional arrangements for production and wealth distribution. Both stories can be said to provide 'tests' of human behaviour, holding the factors of culture and education constant. Story (a) additionally holds time as a constant and varies only in the nature of the economic system. Story (b) does not hold time as a constant and also varies the nature of the economic system. No one would be more convinced of the significance of the predictability of behavioural changes under different constraints than the many Chans and Lees in China. The focus of the above analysis is behavioural change rather than the moral nature of the changes involved. It must be emphasized that some people today may still say that they prefer the way of life under central state planning. They may also insist that the market economy is intrinsically corrupt. The reality is that most people have 'voted with their feet' by leaving planned economies and finding their way by all means to corrupt market economies. Besides, there is ample evidence that central state planning does not guarantee an egalitarian distribution of rights or wealth.

Consider a further real-life example that verifies economic theories. When the tobacco tax was higher in mainland China, cigarettes were smuggled from Hong Kong into the Mainland. Since the tobacco tax became lower in mainland China, cigarettes have been smuggled into Hong Kong from the Mainland. In this example, the factors of culture, political systems, and economic systems are all held constant but relative prices were reversed as a result of variation in taxes in two different jurisdictions. One can predict, that should there be a reversal in relative prices, the direction of smuggling will be reversed again.

## **Influence of Behaviour on the Choice of Constraints**

Causality of influence can work in the opposite direction. Behaviour can influence individual built-in constraints. At an individual level, we certainly see situations where people adopt rules of thumb in doing things, rather than react in a way that is explicable solely by utility maximization. In fact, many 'non-economic' slogans and moral maxims adopted can be regarded as examples of such rigidities. Following Herbert A. Simon, inventor of the concept of bounded rationality, many scholars such as Roy Radner, Brian Arthur, etc. have worked on this problem. Ronald Heiner attempted to rationalize rigidities in terms of their role in information cost reduction. Recently, much attention has also been paid by bio-economists to addressing the question of rigidities, captured recently (in 2002) by the award of a Nobel Prize to Daniel Kahneman.

Behaviour can also influence group constraints in the form of public choice or in the form of regulations and legal principles. This is the premise of an offshoot of the Coasian approach, popularized by Judge Professor Richard Posner of the University of Chicago. Posner's argument is that common law evolves from the efficiency principle of economics. He has given many examples of common law doctrines in which this proposition can be shown. The recent antitrust decision against Microsoft, the global computer software giant, however, enlisted the expertise of Posner in presiding over the bargaining between the company and the United States government. This, among others, is a good example where behaviour can be seen to have influenced the choice of constraints. We shall discuss the relationship between economic and legal inquiry in the last chapter (Chapter 12) of this book.

## **The Use of Economics**

The Nobel Prize rewards contributions to science, literature, and good works for the benefit of mankind. It is not clear, however, on what basis a Nobel Prize has been created for economics. In spite of sophisticated mathematical modelling introduced into the art of economic reasoning, economics as an explanatory tool should not be used in the same meaning of science as used to shoot a rocket to the moon. And explanation is more than just prediction. The use of economics therefore requires certain flexibility in thinking, striking

a balance between positive and normative inquiry, a balance between mathematical modelling and intuitive reasoning, and a balance between the mentality of a scientist and a reformer.

It is an illusion that economics considers itself belonging to the same genetic family of physics, chemistry, and biology. It does not. The many applications in this book are, for instance, conjectural, evocative, and heuristic rather than the last word to a question. However, it will be equally incorrect to view economics as belonging to arts, literature, or an uninstructed method of thinking. The hallmark of good economics, we may say, is the treatment of constraints, a key subject to which we now turn.

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