Ten Fundamental Laws of Economics

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In the midst of so many economic fallacies being repeatedly seemingly without end, it may be helpful to return to some of the most basic laws of economics. Here are ten of them that bear repeating again and again.

1. Production precedes consumption

Although it is obvious that in order to consume something it must first exist, the idea to stimulate consumption in order to expand production is all around us. However, consumption goods do not just fall from the sky. They are at the end of a long chain of intertwined production processes called the "structure of production." Even the production of an apparently simple item such as a pencil, for example, requires an intricate network of production processes that extend far back into time and run across countries and continents.

2. Consumption is the final goal of production

Consumption is the objective of economic activity, and production is its means. The advocates of full employment violate this obvious idea. Employment programs turn production itself into the objective. The valuation of consumption goods by the consumers determines the value of production goods. Current consumption results from the production process that extends to the past, yet the value of this production structure depends on the current state of valuation by the consumers and the expected future state. Therefore, the consumers are the final de facto owners of the production apparatus in a capitalist economy.

3. Production has costs

There is no such thing as a free lunch. Getting something apparently gratis only means that some other person pays for it. Behind every welfare check and each research grant lies the tax money of real people. While the taxpayers see that government confiscates part of one's personal income, they do not know to whom this money goes; and while the recipients of government expenditures see the government handing the money to them, they do not know from whom the government has taken away this money.

4. Value is subjective

Valuation is subjective and varies with the an individual's situation. The same physical good has different values to different persons. Utility is subjective, individual, situational and marginal. There is no such thing as collective consumption. Even the temperature in the same room feels differently to different persons. The same football match has a different subjective value for each viewer as can be easily seen the moment when a team scores.

5. Productivity determines the wage rate

The output per hour determines the worker's wage rate per hour. In a free labor market, businesses will hire additional workers as long as their marginal productivity is higher than the wage rate. Competition among the firms will drive up the wage rate to the point where it matches productivity. The power of labor unions may change the distribution of wages among the different labor groups, but trade unions cannot change the overall wage level, which depends on labor productivity.

6. Expenditure is income and costs

Expenditure is not only income, but also represents costs. Spending counts as costs for the buyer and income for the seller. Income equals costs. The mechanism of the fiscal multiplier implies that costs rise with income. In as much as income multiplies, costs multiply as well. The Keynesian fiscal multiplier model ignores the cost effect. Grave policy errors are the result when government policies count on the income effect of public expenditures but ignore the cost effect.

7. Money is not wealth

The value of money consists in its purchasing power. Money serves as an instrument of exchange. The wealth of a person exists in its access to the goods and services he desires. The nation as a whole cannot increase its wealth by increasing its stock of money. The principle that only purchasing power means wealth says that Robinson Crusoe would not be a penny richer if he found a gold mine on his island or a case full of bank notes.

8. Labor does not create value

Labor, in combination with the other factors of production, creates products, but the value of the product depends on its utility. Utility depends on subjective individual valuation. Employment for sake of employment makes no economic sense. What counts is value creation. In order to be useful, a product must create benefits for the consumer. The value of a good exists independent from the effort of producing it. Professional marathon runners do not earn more prize money than sprinters because running the marathon takes more time and effort than a sprint.

9. Profit is the entrepreneurial bonus

In competitive capitalism, economic profit is the extra bonus that those businesses earn that fix allocative errors. In an evenly rotating economy with no change, there would be neither profit nor loss and all companies would earn the same rate of interest. In a growing economy, however, change takes place and anticipating changes is the source of economic profits. Business that does well in forecasting future demand earn high rates of profit and will grow, while those entrepreneurs who fail to anticipate the wants of the consumers will shrink and finally must shut down.

10. All genuine laws of economics are logical laws

Economic laws are synthetic a priori reasoning. One cannot falsify such laws empirically because they are true in themselves. As such, the fundamental economic laws do not require empirical verification. Reference to empirical facts serve merely as illustrative examples, they are not statements of principles. One can ignore and violate the fundamental laws of economics but one cannot change them. Those societies fare best where people and government recognize and respect these fundamental economic laws and use them to their advantage.

Originally published at Mises.org.