

THE  
**ECONOSPHERE**



WHAT MAKES THE ECONOMY REALLY WORK,  
HOW TO PROTECT IT, AND MAXIMIZE YOUR  
OPPORTUNITY FOR FINANCIAL PROSPERITY

C R A I G   T H O M A S

# The Econosphere

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What Makes the Economy Really  
Work, How to Protect It, and  
Maximize Your Opportunity for  
Financial Prosperity

Craig Thomas

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*To Heidi, who has patiently endured the verbal monologue version of this book for the past 19 years. I love you.*

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# About the Author

**Craig Thomas** has worked as an economist in the private sector for the past fifteen years. Specializing in regional, macro, and real estate economics, Mr. Thomas has held the posts of senior economist and director at Citigroup, CB Richard Ellis/Torto Wheaton Research, and Economy.com. Over the years, Mr. Thomas has modeled and analyzed markets and asset classes around the globe and has presented his work throughout Europe, Asia, and North America.

Prior to this, Mr. Thomas completed his graduate and undergraduate studies at the University of Maine, Orono. While there he studied and gained degrees in economics, with concentrations in agriculture and resource economics, and business.

While writing this book, Mr. Thomas split his time between Manhattan and Nahant, Massachusetts.

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# Preface

When the economy is not giving us the messages that we want to hear, we tend to think of it as broken, unfair, and maybe even a little malicious. Someone ought to step in and fix it or adjust it, just like the government has tried to do now and again. But if the economy is actually a self-sustaining social ecosystem, the same way our physical ecosystem is, perhaps it is better-suited to take care of itself, and our tinkering with it might disrupt instead of help it.

In *The Econosphere*, you finally will understand the laws that govern our financial world—the everyday world of work and play; planning, saving, and investing; and the economic considerations for everything that comprises our daily lives. This is a world that is a most fundamental aspect of everything that we are, and we need to understand it clearly to make intelligent choices. Here, I show you that we are living, breathing, and working within the self-regulating, holistic Econosphere whether we know it or not.

You will understand why others' wealth neither hurts nor benefits you. You will understand what fairness is in an economic sense. And you will see clearly how to make the most of your time and labor.



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# 1

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## Born with a Loaf of Bread

### **How the World Prospers**

My grandmother, the late Althea Thomas of Kunkle, Pennsylvania, had a saying, “Every baby is born with a loaf of bread.” She would say this to comfort someone expecting a new addition to the family who was perhaps worrying about family finances. I suppose the phrase would be the antidote to the less comforting, “One more mouth to feed.” I think it’s a nice saying; it’s soothing and optimistic. Oddly, it has stuck in my head from the first day that I heard it repeated, and I have long wondered why that is. In fact, there is much more to that old adage than just kind, matriarchal reassurance.

It is a wonderful saying because it is absolutely true. And if everyone could just understand that one fact, I think the world would be such a happier, more serene and certainly better managed place for all of us to live. The saying actually goes to the heart of how it is that our economic world can support its billions of inhabitants as well as it does. It can because new inhabitants bring with them the basic raw materials to support themselves and those they

care about throughout an entire lifetime—and in some cases, even produce far more than they ultimately need, which brings us to...

## The First Law of the Econosphere

### **The Law of Growth:**

Unless purposefully hindered, each new person brings additional wealth to the world.

## **We All Share the Same Goal: Maximize Happiness**

I call the environment in which we live the *Econosphere*. It is the world created by and governing of human decision making, and it is our home. It provides for us and nurtures us. It reacts to and informs our every interaction and, if we understand it, allows us to optimize the use of our life spans moment by moment. This environment is not, however, one made of oxygen and hydrogen, oil and steel, high mountains and low plains. Rather, the Econosphere is our *social* environment, where we work, live, raise our families, and govern ourselves. We need to start thinking about the economy as a holistic, natural system. Think for a moment about the biosphere, its makeup and its importance in sustaining life. Scientists study our complex biosphere in incredible detail, employing all kinds of technologies to understand how it sustains us. Most of us

generally accept that the biosphere provides the air we breathe and thus we need to care for it by not overwhelming its capability to renew itself with harmful chemical emissions, heat, and dust. It is the biological part of our environment, and our environment needs to be protected.

What about our social environment? Should we make the same efforts to study and protect our Econosphere? The answer is an emphatic yes! Unfortunately, many people see the economy as simply the outcome of public policy, a collection of opaque statistics, or even a term that describes how much money we are or are not making, saving, or investing. But we generally do not see the economy as a natural system that nurtures and sustains us.

Now, you might be asking what is so perfect and balancing about the economy? Its fits and starts, enormous perceived inequities, and even its seemingly cruel nature give it the reputation of being far from perfect. However, consider what it does for us. On a planet that is home to billions, the Econosphere signals to each of us what needs to be conserved by assigning a market price that is dear. In that same vein, if the price of something is high relative the cost to create it, the Econosphere signals us to put our efforts into supplying more of this thing. On the opposite end of spectrum, if we have too much of one thing, the Econosphere devalues it so that we consume more or produce less of it.

And there are rewards for good behavior; the more productive we are in producing what it is that our fellow inhabitants crave, the more we are rewarded. If we produce great value, we subsequently can consume things of great

value or save our earnings to share with those whom we love. Moreover, like a great coach, the Econosphere motivates us through intense competition to be innovative. The more we innovate, the more we are rewarded; but even better, the more we innovate, the better off we all are because the products and services that we create for our fellow people are ever superior to those that came before. This is what allows us to increase the quality of all our lives over time and allows this small world to make room for all those on its surface.

To those who are inclined to see it, it is breathtaking choreography on a global scale with billions of performers, each one in character, playing his or her unique role so that the entire ensemble shines. The Econosphere provides *for* us, yet it is also *of* us.

Where we do find areas of our social environment that are tarnished and polluted, we also always see a visible interfering human hand. Where there is hunger, there is typically not a lack of food, but rather a closed border, a cruel authoritarian regime, or a captive market not allowed to assign prices or incent production. Where there is poverty, we often find bigotry and artificial castes maintained by brutal rule. Where we see inefficiency and waste, we typically find central planning, public ownership, and favored status. Even in our recent financial crisis, complicit in the mistakes made by lenders, borrowers, and investors is the hand of the central-planner. In this case, public policy subsidizing the purchase of homes via tax breaks and loose borrowing standards had their start in the

Clinton Administration's fixation on increasing the home-ownership rate and the Bush Administration's willingness to carry that torch with its promotion of an *ownership society*—apparently ownership at any cost!

Fortunately, like someone trying to stop the grass from growing by stamping on it, efforts to rob us of our natural social environment are usually short-lived, eventually failing. Like plants sprouting through cracks in a sidewalk, the Econosphere finds ways to guide our lives even as some might work to pave it all over. Similarly, you always find a way to maximize your happiness, even within the confines of those impediments that might be thrown up in your path—it's just that maximum potential happiness is not as high when the Econosphere is not left to function unfettered.

## **Love and Protect Your Econosphere**

If you understand the Econosphere, you can better protect it from harm, just as many seek to do with the biosphere. And when you understand its natural laws, you are much more likely to thrive within it because an understanding of the laws of the Econosphere cannot help but give you an advantage over others who, sadly, might believe that their lot in life is done *to* them, not *by* them. Understanding the Econosphere's functioning and rules can give you the ability to concentrate on where you can add the most value, improve your information so that you can make superior decisions, and to generally be at peace with a

social environment that best serves your needs by being allowed to function naturally.

When you don't understand the forces at play in the world you're living in, anything and everything can be terrifying. But when you have the tools to properly understand and translate information as it comes to you, whether it is in understanding the pros and cons of a candidate's proposed public policy, why the job market functions as it does, why the marketplace prices goods and services higher or lower, or even why you make the life and work decisions that you make, there comes a peace of mind.

## The Second Law of the Econosphere

### **The Law of Information:**

In the Econosphere, no matter what the problem, better information is always part of the solution.

## **The Marketplace Is Perfect: It Is Information That Is Imperfect**

It is not the functioning of the economy that creates adverse outcomes; rather it is poor or inadequate information and lack of understanding that causes you to make ill-advised and costly decisions.

If you manage to collect and decipher better information than is commonly available, there is a greater chance that the Econosphere can work better for you. It's not so much that you need to discover unique facts, but rather

that if you can take the same information that others have in front of them and understand it all at a much higher level, discarding the noise and making better use of your understanding of the natural laws of the Econosphere, you can thrive.

Even among professional economists, quite a few cannot sort through the day's headlines and filter for themselves those events that are relevant to the economy from those that are a distraction, and then make the decisions that benefit their lives and the lives of their loved ones. If you don't understand the Econosphere, there is a likelihood you will lurch from headline to headline, grabbing hold with both hands every upturn and downturn in the news cycle. You will greet every statement with apprehension and will have little basis to judge the quality of every promise.

For instance, consider our recent economic problems, the roots of which took hold with the burst of speculative investing in housing starting in 2004. (The roots go deeper than that, specifically to the earlier-mentioned incentives created by public policy, but those are aside from the point I want to make here.)

Is there anything wrong with a house per se? No, houses are good things. So, what was the problem? Investors (both homebuyers and major institutions that secured or invested in the underlying mortgages) over-estimated future house price gains. Lenders under-estimated the risk in lending to households for the purpose of purchasing over-valued homes. Builders built too many homes, expecting demand to



remain elevated. The problem was not that the market readily allows for the construction and purchase of homes. Rather, we had an information problem. Investors ignored housing affordability as an indicator for home values; builders lost track of basic demographic certainties; banks forgot the number one rule of banking—never lend to someone who really needs the money!

So, we ended up with a mess that spread well beyond housing to every facet of the global economy. And how do we get out of a mess like this? Investors that made poor investments need to accept their losses. Banks need to foreclose upon bad loans. Builders need to stop building houses.

What about all the emergency actions that were undertaken? Ultimately, the astounding array of new policies did not stop any of the inevitable pain, but did cost U.S. taxpayers billions while likely prolonging and spreading our problems. We can see now that by intermittently and unpredictably changing the rules of the game for businesses and households so that information became even more muddled, these measures likely increased the risks inherent in our decision making.

Would it have been worse had these new policies not been put in place? No one can say with any certainty because the Econosphere does not allow for do-overs. However, given that the mess only got worse even after the measures were put into place, we must conclude that the goals of the policies were not fulfilled. And this is not terribly surprising because none of these policies were done

with any reverence to the natural functioning of the Econosphere. No matter how well intentioned they were, they never actually had a chance.

Along these same lines, we cannot help but wonder *what if* housing speculators and mortgage lenders (not to mention the FDIC, Federal Reserve, Congress, and whoever else might also act as an anointed public overseer) had better information before any of this had begun, it all could have been avoided. Better knowledge of and respect for the powerful natural laws of the Econosphere would have saved us a lot of time and headaches! We cannot improve the Econosphere anymore than we can improve upon the laws of physics, but we can improve information.

Just as in our physical environment, the rules and functioning of the economy are essentially constant, unaffected by our day-to-day considerations about our work, leisure, saving, and consumption. It is always unique or superior information that helps us make better decisions. And, even our choices in politics are one way we express our understanding of what harms or helps us within the Econosphere. In the same way that someone can avoid chemicals that harm the physical environment, you might also vote against a candidate who proposes policies that might impede the proper functioning of the economy by encouraging or discouraging certain kinds of production or consumption, or in adversely changing the way that the economy distributes scarce resources.

## You Live in the Econosphere

Because economics is about making decisions, you must see your economic condition as a collection of actions—past and present—made by individuals to increase each individual's happiness. And you should not just see this as simply a product of consumerism or greed—many wonderful things make you happy that are not related to stereotypes of mindless consumption for-its-own-sake. Happiness can be derived from providing for your family, preserving free time to mentor young people, the pursuit of the arts, or the opportunity to engage in charitable activities. It's all the same, as long as it brings you happiness. Every day you decide what makes you happy, and you make decisions to achieve your goals with whatever information you can gather. You do this every second of every day that you are awake. (You even shape your sleeping habits to maximize your happiness as well!)

You are born to live in your environment; both a physical environment and a social environment. Your physical environment should be plainly obvious to you. It's the sun to warm you, air to breath, food to sustain you. Your social environment is mostly invisible, and the parts you encounter can seem chaotic and not particularly interconnected. Until you know what the rules are, it's going to be difficult to contemplate and enjoy the Econosphere. But whether you understand it or not, you are living in it. Just as you don't need to be an environmentalist to breathe air or drink water, you don't need to be an economist to function within the Econosphere and work to maximize your happiness. It's inborn.

## Can You Be Green About Your Econosphere?

There is a great deal of cultural emphasis today in being “green,” the belief that you are better off taking care to eat wholesome and nutritious food, minimize your negative impact on the physical environment you share with everyone, and generally become a better steward of those resources you use to sustain yourself. For instance, you might choose to eat organic foods because you believe that the chemical applications found in the production of conventional agriculture contributes to unwanted chemical runoff into our aquifers or perhaps even the buildup of such chemicals within your own body.

In choosing to be green, you use the information that you have in hand to make what you believe is the best decision for our physical environment and for yourself. That is not to say that you are correct, but each of us tries to employ the best information that we have and that we can gather to make the right decisions. In the instance of avoiding pesticides, you have gathered enough information to come to the conclusion that you can achieve the most happiness by buying and consuming organic food.

If you can see your choices regarding the physical environment that are intended to bring you happiness, you can then expand this understanding to the less well-understood realm of your social environment—the Econosphere. Of course, your decisions regarding your physical environment are in the realm of the Econosphere, as well. However, how

you *choose* to work and consume as part of our economy can be a bit harder to see and appreciate. How you choose to use finite resources, whether clean water or your own life span, are economic decisions.

You automatically become more productive if you can receive and react to the incentives and disincentives provided within the Econosphere. If there is too much of one thing, the price goes down, and thus supply reacts by cutting production. If we have too little of a thing (gasoline), the price rises, some of us step in with more supply, or even create alternatives to that good or service.

You are optimally productive if you can react to market pricing, dedicate yourself to a task, and trade the goods and services you produce freely, seeking the best value for your effort. The more productive you are, the greater your collective wealth and well-being. Also, the more productive you are at work, the more opportunity you have to be at leisure, another key ingredient to maximizing happiness.

To these ends, you must receive signals from the economy as to the value of goods and services that you can produce to trade for others' goods and services. It is essential for your own good that you develop an appreciation of how the Econosphere works so that you see the information necessary for you to provide for yourself and your family and optimize the value that you bring by employing all the abilities and possibilities that come in the course of your life. It is really about understanding and appreciating the natural

flow of this holistic system of interaction, so you can make good decisions in work and play to receive the full value implicit in your very existence, and second, not do anything to harm or impede the Ecosphere's natural functioning. You are the steward of your environments, both physical and social.

Which brings us to...

### The Third Law of the Ecosphere

#### **The Law of Sustainability:**

The Ecosphere's bounty comes from people and nothing else. The animating force of the Ecosphere is humanity.

Because the Ecosphere is the result of our work and our choices, the basic building block of the Ecosphere is the human life span. Human energy is our basic raw material, not oil, gold, soil, or water. Sure, we do need a physical space to inhabit, but there is, nonetheless, no value creation or intrinsic worth without us. Thus, all economic worth radiates from the time *we* are afforded and those talents that *we* cultivate within each of us.

As an example, let's see why the economy is about us and not some commodity like oil. Oil in the ground is absolutely worthless. Oil without the combustion engine is worthless. Oil without people wanting transportation across long distances or to heat their homes or to generate power is worthless. It is only worth something if it is pumped to the surface, transported, refined, and eventually consumed.

That entire process is done with the consumption of human time and talent. Moreover, the extent to which that process is possible and optimally performed depends on whether inhabitants of the Econosphere are fully able to collaborate and trade with one another.

What the Econosphere does is create the signals, that is, market prices that prompt some people to see the need for oil and motivate them to find ways to extract, refine, and trade that oil for money with which to purchase goods and services to maximize happiness. The Econosphere provides the basic flow of information, incentives, and disincentives to guide each of our daily lives. Now, I use oil only as an example. The same analysis can be used in the production of bread, financial advice, music, or robots. None of the raw materials that go into the production of such goods and services is worth anything without the essential ingredient: the human life span.

Let's look at the natural process of our lives. First, most people are born with the essential capacities to provide their sustenance—though we should acknowledge that for those who are oppressed within command economies or in societies where bigotry bars some groups from education or certain vocations, such people might never live up to their potential. Yet, even acknowledging that some in this world are held back by the hand of another, it is never a question of slicing up a pie made up of all the wealth and resources on earth into ever smaller pieces to support increasingly more people. Rather, the pie actually gets bigger with the addition of each person. Every individual human being

actually bakes his or her own piece of that incredible pie! Even better, whereas people are born with a body and intellect that sustains them, that ability is not fixed. It can be enhanced, refined, and specialized to cause you to become ever-more differentiated and productive. We have what we are born with, and we also have everything that we invest in ourselves or others invest in us throughout our lives. We get better over time; the result of which is that we eventually produce more than we need. That excess allows us to prepare for the possibility of being less productive later in life and yet still maintain our standard of living. Is this a great system, or what? Well, it doesn't feel like that all the time.

## **The Econosphere's Tough Love**

Consider some of the topical economic issues of our time, and how you might or might not view these issues depending on your understanding of the Econosphere and from where value really flows. Take for instance, the fear of trade. At its core, there's nothing alarming about trade, right? Someone somewhere makes something and is willing to trade it for something else made by someone living elsewhere. It sounds kind of nice in a sort of trade-bread-not-gunfire sort of way, doesn't it?

Oh, but how we worry about it. It makes some of us ache with fear; it makes others head to the street with signs and even bricks to throw through windows in protest. How can this simple exchange of talent and time generate such



extreme passions? Why would you want to restrict the ability to trade the product of one person's toil for the product of another person's toil, and why does it matter if these exchanges take place over some distance?

The problem is that you do not live in the abstract. Exchanges of good and services, if you do not understand your economy as a system preserving sustainability and prosperity, might look something akin to anarchy, and within that anarchy there is one person in one land providing a good that could otherwise be produced domestically. Free trade can look a lot like theft: They're stealing our jobs! However, if you can see that if one region of the world can concentrate on those things that they do most efficiently, then another region can concentrate on what they do best. The end result is more goods for all because everyone would operate as efficiently as possible.

Part of the problem comes from the fact that we do not think as a region, or as a people. We are individuals; we think as individuals and, understandably, we value continuity and predictability in our lives. We are happiness maximizers within the Econosphere, and the happiness that we maximize is our own. If one person builds his life and his household around a particular vocation, community, or culture that is in turn built around a particular industry that is adversely affected by shifting comparative advantages around the globe, then talk of optimal efficiency is of no comfort at all! Free trade, certainly in the short term, has the potential to be upsetting, no question about it.

To see the industry where your parents toiled successfully now fail and wither or to watch the town where you grew up crumble is a genuine loss that is hard to get over. So what is the answer? To some, it might seem that the solution is to control trade flows to protect industries and ways of life that might well disappear if forced to compete with every distant competitor. Protection always sounds comforting to some, particularly those directly and severely affected by the changes that do take place in the economy over time.

## **What Happens When We Try to Stop Change? Here's Your (1952) Buick!**

Imagine if you could stop the forces of innovation by preserving every industry that we have today; every region might remain unchanged, and every person might never have to face the stress of moving, retraining, or scrapping previous expectations for life with new plans requiring the pursuit of a different field or even moving a household far away from the familiar. Now think of a place that has tried to isolate its Econosphere from the rest of the world, like North Korea or Cuba. Want to trade your car for a bicycle, or a 1952 Buick?

When you try to cut off all or part of your Econosphere from the real, global Econosphere, it's a little like trying to keep a rainstorm from sweeping across your state. Not only will you still get wet, but you're likely to catch a cold, too.

Trying to drop out of the Econosphere slows productivity, and living standards start to go down. We would no longer see advances in technology, medicines, or the phenomenally efficient services, like UPS and cell phones that we take for granted. You could afford fewer things than you otherwise could, and you would invest less than you otherwise would. You would create less than you otherwise create, understand less than you otherwise understand, and you would become less than you otherwise are.

Over the last few centuries, we have learned a lesson about our relationship with the biosphere. We have seen that attempting to impose mankind's will over nature often creates unintended negative consequences that make us all worse off, rather than better off. For instance, we have seen that the thoughtless damming of rivers can endanger fish and other wildlife, compromise the fertility of our land, or increase the risks that can come from extreme weather. We have learned that it is better to work in harmony with nature rather than to inflict our will wantonly upon it. We know that to ignore the contours of our physical world leads to flood, famine, disease, and illness.

Slowly but surely, the "green" movement has made us aware of our individual impact on the biosphere and put pressure on public and corporate policy to better align and harmonize with its protection. Whereas most people would not want the ascendancy of humans to somehow be impinged upon, we have become more intelligent about managing the impact on the biosphere because we see that it is in our best interest to respect what sustains us and that

we cannot or should not control. We have even come to understand that our environment can provide some goods and services better than we can, whether that is natural topography shaped by centuries of forces or wild ecosystems that provide us with, say, food in the case of our oceans and rivers, or with a balance of plant and wildlife that maintain balance and livable space, so we correctly leave it up to nature.

You need to come to the same understanding when it comes to the Econosphere. The Econosphere is best left to encourage people to produce those goods that they have an advantage producing, as that production leads to maximum happiness. For those who have less comparative advantage in a particular area, the Econosphere encourages them to find other outputs for their talent. Although that might be harsh in the short term, and it often is, you cannot forget that you have two basic roles in the Econosphere: You create, and you consume the work of others. Let's take a look at how these two sides of your life in the Econosphere interact.

## **The Protection Racket**

Any tariff or barrier to trade that is erected to shelter an industry that can't compete is actually a subsidy for that producer and a tax on the consumer. Protect a T-shirt maker in Tennessee (and all the other American T-shirt makers) from those cheap T-shirt makers in Indonesia, and suddenly every T-shirt in America is going to cost more.

Same for cars and toasters and telephone answerers. So protecting one person, a business owner, or employee, by restricting the natural functioning of the Ecosphere, takes away from every person who needs to buy that protected product because the price is going to go up.

But it gets worse. The impulse to try and fiddle with the incentives in the Ecosphere (and go against its natural laws) causes the Ecosphere to run less efficiently. Before long, with less competition, we get less output per worker, less per set of raw materials, and less per unit of time. On net, we all lose. Within that accounting, it is the consumer that gives up something to make the producer's life easier and less prone to change or stress. But who is looking out for the consumer? What did the consumer do to warrant having to bear such a cost? And let's not forget: We are all producers *and* consumers. Even the subsidized producer faces higher prices in the end result!

Over time, there are few one-for-one tradeoffs because lost efficiency in one area of the Ecosphere hurts the entire ecosystem. Moreover, because we each put our individual finite energy into the Ecosphere, the output that springs forth from the economy depends on us. We are not taking wealth from each other; all of us are the fountain from which the value springs. It might look as if some of us get wealthy on the backs of others sometimes, but the underlying truth is often obscured by the passions of the moment.

Feel like it's time for another law? You're right!

## The Fourth Law of the Econosphere

### **The Law of Plenty:**

The Econosphere never takes from one to give to another.

## **The Kinder, Gentler Econosphere**

The Econosphere is a natural system that challenges us to improve via competition, but it never takes away from our great shared wealth. What appears to be seizure are just shifting relative surpluses and deficits that affect market prices and incentives. This is another important point. In the Econosphere, for one to win, it does not dictate that another loses. It is a natural system that challenges us to improve via competition, but it never takes away in the aggregate.

It is clear that some people who do not fully grasp this natural system that sustains us might, in fact, believe that the untamed, wild Econosphere is a malevolent force robbing the weak or innocent. I believe that they are wrong. I would even go so far as to argue that the Econosphere is not even a neutral system. Rather, our economy is a benevolent system that rewards those who come to terms with it and learn to understand and live in harmony with it. I might also argue that the economy is forgiving in that it rarely takes away from those who otherwise are not believers and who see only anarchy in the workings of the Econosphere.

After all, you don't have to believe in the wisdom of the market to be governed by the economy's system of incentive and disincentives. It governs us all, and while it is a trusted advisor and mentor to those who see Adam Smith's "invisible hand" (where in a free market, an individual pursuing his own self-interest tends to also promote the good of his community as a whole) as a guide, others do not see a hand, but rather a cruel and random unseen force.

Even if personal outcomes from one person to another are at times similar, the personal experience and interpretation can be quite different. Remember, we are all utility maximizers, and we equate utility with happiness. Seeing the Econosphere for what it is and what it provides is certainly happier and more comforting than fearing perceived chaos. Without understanding the functioning of the economy, you might see only the outcomes without ever understanding the reason behind those outcomes, and that's just not any good at all.

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