

Revised Edition

Common Sense Economics

*What Everyone Should Know
About Wealth and Prosperity*

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P r e f a c e

Why Should You Read This Book?

We know that your time is valuable. Most of you do not want to spend a lot of time learning new terms, memorizing formulas, or mastering details that are important only to professional economists. What you want are the insights of economics that really matter—those that will help you make better personal choices and improve your understanding of our complex world. And you want those insights to be presented in a concise, organized, and readable manner, with a minimum of economics jargon. We wrote this book to meet these objectives.

You can profit from this book regardless of your current knowledge of economics. This book will introduce a beginner to the basic principles of economics, principles that mainly reflect common sense. But these concepts are powerful tools for logical thinking that will quickly make it possible for even beginners to distinguish between sound economics and romantic nonsense. This book will also help more advanced students of economics and business pull together the “big picture.” Advanced students, including some at the graduate level, are often so busy with graphs, formulas, models, and technical mathematics that they fail to understand the really important lessons of economics. Finally, an experienced business executive or a policy maker can also learn much of value from this book. Even those who are highly successful at their jobs often underestimate the far-reaching, typically unintended effects that political rules and policies have on the broader economic health of people and nations.”

Now, as in the past, two visions are competing for the minds and hearts of Americans. One is of limited government, economic freedom, and personal responsibility; the other, expanding government, collectivism, and dependency. America was founded on the first, but the second has been in ascendance for at least a century. Under the first vision, the economy will be directed by personal choices coordinated by markets; under the second, by central planning and politics. It makes a big difference. As the renowned Stanford economist, Thomas Sowell, has put it, “*The first law of economics is scarcity, and the first law of politics is to disregard the first law of economics.*”

We have better knowledge about how these two alternatives work than at any time in history. But we are a nation of economic illiterates. As a result, we are easily misled by leaders who tell us of their good intentions – their passion to solve our problems. One of the 20th century’s greatest economists, Milton Friedman, once stated, “There’s nothing that does so much harm as good intentions.” This was his way of stressing that policies should be evaluated on the basis of their effectiveness, not the intentions of their proponents.

President Herbert Hoover, Senator Reed Smoot, and Congressman Willis Hawley had good intentions when they pushed the Smoot-Hawley tariff increases through Congress in 1930. Nonetheless, the consequences of this legislation were disastrous; it helped turn what should have been a normal downturn into a decade of pain and suffering. The 18th century surgeons also had good intentions; they thought amputations without anesthesia bathed in wine would prevent diseases from getting into the blood of their patients. But their good intentions did not protect their patients from the adverse affects of their treatments. Neither will the good intentions of modern day politicians protect us from the consequences of harmful policies.

The massive government intervention leading up to, and following, the economic crisis of 2008 has generated an increasingly urgent need for basic economic education. Our democracy puts voters in charge of choosing our policy makers, so the consequences of economic illiteracy can be disastrous.

People who do not understand the sources of economic prosperity are susceptible to schemes that undermine both their own prosperity and that of their country. A nation of economic illiterates is unlikely to remain prosperous for very long.

If you are concerned about the direction of America and would like to see a road map for a more economically free and prosperous future, this book provides it. The basic principles explained here will help you better understand what types of economic arrangements work, what restraints on the political process are needed to strengthen and preserve them, and thus why some nations prosper while others stagnate or even regress. As a result, you will be able to make wiser choices as a citizen. But basic economics will also help you make better choices with regard to your consumption, saving, investments, career alternatives, and many other dimensions of personal decision-making. As we explain in Part IV, economics provides some simple rules on how to build and grow wealthy. And in a market economy, increasing your wealth helps others become wealthy too.

There is an Internet website, <http://CommonSenseEconomics.com>, that accompanies this book. For those who want to dig deeper, the site includes supplementary units that address specific subjects such as gross domestic product, measurement of inflation, banking and monetary policy, the Great Depression, and the Economic Crisis of 2008. (Note: the full list of these topics is listed in the back of this book.) These supplementary units were developed at the request of instructors using Common Sense Economics as a text who wanted a more comprehensive analysis of various topics. This material will meet this demand and provide instructors with maximum flexibility for the development of their course. The CSE website also includes numerous other features such as study questions, a secured instructor's test bank, links to videos, classic readings that can be downloaded to a MP3 player, and many other features that will make economics livelier for both students and instructors. Our goal is to make economics fun, as well as informative.

—James Gwartney, Richard Stroup, Dwight Lee, and Tawni Ferrarini
April 2010