Common Sense Economics for Life

Common Sense Economics: What Everyone Should Know about Wealth and Prosperity, Third edition, (2016) by James Gwartney, Richard Stroup, Dwight Lee, Tawni Ferrarini, and Joseph Calhoun is out.

History and Overview of *Common Sense Economics* and accompanying learning tools:

- For over a decade, the Stavros Center for Economic Education of Florida State University has collaborated with a team of master teachers and leading economic educators to develop materials that focus on what students really need to know about economic reasoning. The *Common Sense Economics* textbook and the accompanying course shell are the products of this project.
- *Common Sense Economics* explains the key principles of economics and illustrates their application to markets, the political process, and personal finance. It is written in a lively style, well organized, and easily understandable. It will help readers make purposeful choices and enhance their understanding of the real world and what might be done to improve it.
- *Common Sense Economics* highlights the wisdom of both Adam Smith and the American founding fathers. Part 1 focuses on 12 key elements of economics, including the power of incentives, gains from trade, demand and supply, the role of profit and loss, the operation of markets, and the importance of unintended secondary effects. These concepts are then used in the other three parts of the book to explain why some nations prosper while others stagnate (Part 2); the potential of productive action through government and why the political process is often dominated by interest groups, government favoritism, and unsustainable debt (Part 3); and how individuals can improve their personal financial decision-making and live a financially secure, personally rewarding life (Part 4).
- *The accompanying course shell for the third edition has been fully updated in Canvas, Blackboard and Moodle 2.9.* It includes standard learning objectives, videos, exercises, audios, excel spreadsheet activities, PowerPoint slides, creative homework assignments, and other assessment materials. These tools will directly engage students in the learning process and meet them in the preferred multi-media spaces. The electronic package provides instructors with all of the resources needed to successfully motivate their students and make learning fun, and it is available free of charge to textbook adopters.

What economic educators are saying about *Common Sense Economics*:

- "Voters, young and old, will welcome a set of crystal clear, time-tested, and logical economic principles which address building national prosperity, personal wealth, and bringing efficiency to government. *Common Sense Economics* opens the door to rational economic, political, and personal choices. It offers a nearly indispensable path to clear thinking. It is perfect for both high school and college students." —Mark C. Schug, Professor Emeritus, University of Wisconsin Milwaukee

- "The authors tell us what everyone should know about economics in language we can all understand. It's refreshing, when five of the best in the profession avoid the all-too-common practice of writing in a code that only other economists can comprehend." —Robert McTeer, former President, Federal Reserve Bank of Dallas
- "*Common Sense Economics makes* economic principles as obvious and simple as they can be. By weaving careful reasoning with memorable examples and clear writing, the authors explain how economies grow (or don't grow); how prices coordinate economic activity; and how governments promote or deter economic progress. This is an extraordinary contribution to economic education." —Kenneth G. Elzinga, Robert C. Taylor Professor of Economics, University of Virginia
- "*Common Sense Economics* takes the economic way of thinking to the next level. If every high school graduate understood the principles in this book, people would make wiser choices as consumers, producers, and citizens and the United States would be more prosperous." —John Morton, former vice president for Program Development, National Council on Economic Education

What students are saying about *Common Sense Economics*:

- "Taking this course has really opened my eyes relative to economics and given me a whole new appreciation of what is going on with government spending and its ramifications. I think all Americans, not just politicians, should be required to take an economics course." —Gretchen Hayn, CSE Educators' Course (3 graduate credit hours), University of Colorado – Colorado Springs, Spring 2016
- "I have watched a few of the videos, actually, and I have been doing my reading. I am finding it hard to put my book down when I read it. It is very interesting! It makes complete and total sense (thus, the name, I'm sure). You all did a great job! To be honest, I was expecting the book to be very "dry" and it is anything BUT." —Julie, Northern Michigan University student, EC101 (4 undergraduate credit hours), Fall 2015
- "Class is going very well. I have to say, I am enjoying it more than I thought I would. Very nervous at the beginning but CSE makes it very simple to understand and follow. I don't go through a day where I am not aware of what I am learning through the class. Economics rules! (And I am not just saying that to butter you up....seriously, I find myself really thinking about how it impacts everything around us.) I also find myself talking to people around me about the readings and videos and how it all comes together through some pretty basic and straightforward principles. I should have taken this course long time ago. My perspective on a lot things has changed quite a bit!" —Cesar, Northern Michigan University student, EC101 (4 undergraduate credit hours), Fall 2015

<u>Excerpts from *Common Sense Economics* (2016)</u>:

- **From the Preface:**
  - *The authors of this book want you to live a successful and fulfilling life. We also want to enhance your understanding of our fast-changing world. Because your time is valuable, we have crafted this publication in a way that minimizes the time spent learning new terms, memorizing formulas, or mastering intricate details important only to professional economists.*
  - *The authors—the Common Sense Economics team—are all economic educators. If you are an economics instructor, we want to help you become a great teacher. To that end, we have developed a multimedia course package to accompany the book.*
- **Importance of incentives:**
  - All of economics rests on one simple principle: Changes in incentives influence human behavior in predictable ways.
- **Opportunity cost:**
  - Have you ever thought about why women with more education are more likely to work outside the home than their less-educated counterparts? Opportunity cost provides the answer. The more highly educated women will have better earning opportunities in the workforce, and therefore it will be more costly for them to stay at home. The data are consistent with this view. In 2013, 79.5 percent of women aged 25 to 64 with a college education (or more) were in the labor force, compared to only 64.4 percent of their counterparts with only a high school education and 46 percent of the women with less than 12 years of schooling.
- **Gains from Trade:**
  - The foundation of trade is mutual gain. People agree to an exchange because they expect it to improve their well-being.
- **Role of profit and loss:**
  - The reward-penalty structure of a market economy is clear. **Entrepreneurs** who produce efficiently and who anticipate correctly the goods and services that attract consumers at prices above production cost will prosper. In contrast, business executives who allocate resources inefficiently, into areas where demand is weak, will be penalized with losses and financial difficulties.
- **Production of value versus jobs**
  - The focus on creating jobs can be extremely misleading, as an apocryphal story about an engineer visiting China illustrates. He came across a large crew of men building a dam with picks and shovels. When the engineer pointed out to the supervisor that the job could be completed in a few days, rather than many months, if the men were given motorized earthmoving equipment, the supervisor said that such equipment would destroy many jobs. "Oh," the engineer responded, "I thought you were interested in building a dam. If it's

more jobs you want, why don't you have your men use spoons instead of shovels?"

- **Importance of secondary effects:**
  - Once the secondary effects of trade restrictions like the sugar quota program are considered, there is no reason to expect U.S. employment to increase as a result. There may be more jobs in favored industries, but there will be less employment in others. Trade restrictions reshuffle employment rather than increase it. But those who fail to consider the secondary effects will miss this point.
- **Economic growth and living standards:**
  - During the past 200 years, economic growth, particularly in the West, has elevated living standards and improved both the length and quality of life. This period, however, is exceptional. Throughout most of human history, economic growth has been extremely rare. Prior to 1800, most of the world's population worked hard for 50, 60, and 70 hours per week in order to obtain enough food and shelter for subsistence. Living standards in 1800 were not much different than a thousand years earlier, or even 2000 years earlier during the time of ancient Rome.
- **Role of competition:**
  - Competition gives firms a strong incentive to develop better products and discover lower-cost methods of production. It harnesses personal self-interest and puts it to work elevating our society's standard of living.
- **Occupational entry restraints and earning opportunities:**
  - As recently as 1970, fewer than 15 percent of Americans worked in jobs that required a license. Today, the figure is nearly 30 percent, and it is continuing to grow. The supporters of licensing argue that it is necessary to protect consumers from shoddy and potentially unsafe products. But, licenses are required in numerous occupations that have little to do with public safety or protection of the consumer. For example, one or more states require a person to be licensed in order to work in the following occupations: interior designer, makeup artist, florist, hair braider, shampoo specialist, dietician, private detective, athletic trainer, tour guide, hearing-aid fitter, funeral attendant, casket seller, and even a ferret breeder and a palm reader. The pressure for licensing seldom originates from consumer groups. Instead, it nearly always arises from those already in the occupation. This is not surprising to economists because the current suppliers are the primary beneficiaries of licensing.
- **Monetary stability and economic progress:**
  - Monetary stability is an essential ingredient of the environment for economic progress. Without monetary stability, potential gains from capital investment and other exchanges involving time commitments will be eroded and the people of the country will fail to realize their full potential.
- **Trade restrictions and living standards:**

  - Trade restrictions neither create nor destroy jobs; they reshuffle them. The restrictions artificially direct workers and other resources toward the production of things that we produce at a higher cost than others do. Output and employment shrink in areas where our resources are more productive—areas where our firms could compete successfully in the world market if it were not for the impact of the restrictions. Thus labor and other resources are shifted away from areas where their productivity is high and moved into areas where it is low. Such policies reduce both the output and income levels of Americans.
- **Dangers of the growing hostility toward trade:**
  - History indicates that the growing hostility toward trade is potentially dangerous. As the economy slowed in the late 1920s, hostility toward trade developed. This led to the passage of the Smoot-Hawley trade bill at mid-year 1930. President Herbert Hoover, Senator Reed Smoot, Congressmen Willis Hawley, and other proponents of the bill thought higher tariffs would stimulate the economy and save jobs. The results were dramatically different. The tariff increase angered foreigners, and sixty countries responded with higher tariffs on American products. International trade plunged and so did output in the United States. By 1932 the volume of U.S. trade had fallen to less than half the level prior to the bill. Unemployment stood at 7.8 percent when the Smoot-Hawley bill was passed, but it ballooned to 23.6 percent just two years later.
- **Institutions and economic progress:**
  - The area of study that analyzes the impact of institutions and policies on economic growth, development, and performance is known as the New Institutional Economics. According to this view, institutions and policies that encourage productive actions and discourage predatory behavior provide the key to growth and prosperity. While there is some debate about the precise institutions that are most appropriate for the achievement of rapid growth, there is considerable agreement that secure property rights, open markets, monetary stability, and minimal trade restrictions are central to the establishment of a sound institutional environment.
- **Economics and the political process:**
  - Government expenditures now constitute 40 percent or more of national income in the United States and several other countries. Given its size and scope, understanding how political allocation works is vitally important. During the past half century, this topic has become an integral part of economics. Economists use the term **public choice** when referring to this area of study.
- **Economics of market failure:**
  - Our analysis indicates that public goods and externalities may undermine the efficient operation of markets. Economists use the term **market failure** to describe the situation where the existing structure of incentives creates a conflict between personal self-interest and getting the most out of the available

resources. Market failure encourages self-interested decision-makers to engage in counterproductive rather than productive activities.

- **Market failure and government failure:**
  - Economic analysis indicates there are cases where markets will fail to allocate resources efficiently. But this is also true of the political process. Put another way, there is government failure as well as market failure. **Government failure** is present when the incentives confronted by political participants encourage counterproductive rather than productive use of resources. Like market failure, government failure reflects the situation where there is a conflict between what is best for individual decision-makers and getting the most value out of resources.
- **Special interests and the political process:**
  - Democratically elected officials can often benefit by supporting policies that favor special-interest groups at the expense of the general public. The tendency of the unrestrained political process to favor well-organized groups helps explain the presence of many programs that reduce the size of the economic pie.
- **The shortsighted bias of the political process:**
  - The political attractiveness of spending financed by borrowing rather than taxation is not surprising. It reflects what economists call the **shortsightedness effect**: the tendency of elected political officials to favor projects that generate immediate, highly visible benefits at the expense of costs that can be cast into the future and are difficult to identify.
- **Government favoritism and inefficient use of resources:**
  - Once businesses and other interest groups become heavily involved in providing politicians with support in exchange for subsidies and favoritism, these forces will be very difficult to restrain. As government favoritism grows and both the recipients and politicians become more dependent on it, transfer spending will grow and resources will move away from productive activities. Moreover, deceitful behavior, unethical relations, and even corruption will become commonplace.
- **Competition among governments:**
  - Competition among decentralized government units—state and local governments—also can help protect citizens from government exploitation. A government cannot be oppressive when citizens can easily choose the “exit option”—move to another location that provides a level of government services and taxes more to their liking.
- **Improving the political process:**
  - If government is going to be a positive force for economic prosperity, the rules of the political game must bring the self-interest of voters, politicians, and bureaucrats into harmony with economic progress.
- **Economics and personal finance:**

- The principles, guidelines, and tools presented here could be divided into four categories. Elements 1 and 2 focus on how you can earn more; Elements 3 through 6 on how to get more value from your income; Elements 7 through 10 on earning more from your investments; and Elements 11 and 12 on management of risk. The advice outlined here is basic, practical, and understandable. It will not make you a Wall Street wizard or an instant millionaire, but it will help you avoid major financial errors.

- **Thinking about career choices:**
  - Sound career decision-making involves more than figuring out those things that you do best. It is also vitally important to discover where your passions lie—those productive activities that provide you with the most fulfillment. If you enjoy what you do and believe it is important, you will be happy to do more of it and work to do it better. Thus, competency and passion for an activity tend to go together. Moreover, real wealth is measured in terms of personal fulfillment.
- **Budgeting and achieving your goals:**
  - Most financial insecurity today is the product of unsound choices. Spending more than you earn, building up debt without concern for how to repay it, lack of budgeting, and other unwise financial habits create havoc and cause stress. A commitment to budgeting is key to obtaining a healthy financial life and achieving your personal goals. Successful personal finance involves strategic planning. There must be a plan in place to guide how the spending, saving, and investment are directed toward wealth creation. For the individual or household, that plan is a **budget**. A budget helps you channel your funds toward sound spending, regular saving, and diversified investments in a manner that will provide you with the most value from your income.
- **Prudent use of a credit card:**
  - Imprudent use of credit cards can be a huge stumbling block to financial success. Although many people are careful with cards, others act as if an unused balance on a credit card is like money in the bank. This is blatantly false and dangerous thinking. It is best to think of your credit card as a means of using what you have in your checking account. If you have funds in your checking account, you can use your credit card to access those funds—if you pay off the bill every month. If you don't have sufficient funds in your account, don't make the purchase.
- **The ordinary investor and the stock market:**
  - When held over a lengthy time period, a diverse holding of stocks has historically yielded both a high and relatively stable rate of return. Do not allow a lack of time and expertise to keep you out of equity investments. You do not have to do a lot of research or be a "super stock picker" in order to be a successful investor. Regular contributions into an indexed equity mutual fund will provide you with attractive returns on long-term investments with minimal risk. For most, these investments will be an important ingredient of a sound retirement plan.
- **Borrowing to invest in education:**

    - It is risky to borrow a large sum of money to finance an education expected to result in low future earnings. As we indicated in Part 4, Elements 1 and 2, it is important to choose a work activity that you enjoy. But, your choice needs to be well informed. Search for and discover the expected earnings in the occupations for which you are training. We want you to make informed choices that will lead to the largest possible return on your educational investment—including the personal satisfaction you derive from the employment.
- **Insurance and managing risks:**
    - How can you manage risk and protect yourself from the most adverse consequences? Insurance can reduce the financial loss resulting from damages to possessions (such as your home or car), an illness, loss of income, or other harmful events. Insurance provides a way for a group of people to pool payments and share risks in order to offset the losses of members actually damaged by an adverse event.
- **Economics and successful living:**
    - To a large degree success in life is about setting goals, working hard to achieve them, figuring out how to make your services useful to others, saving for a specific purpose, and spending money wisely. These are the key ingredients for success. Economics provides the recipe for how to live a more fulfilling life. It is our hope that today you will start on a new journey – that you will earnestly resolve to take control of your life and choose options more consistent with success.