

A photograph of several white wind turbines in a field of yellow wildflowers under a blue sky with scattered clouds. The largest turbine is in the foreground on the right, with two others further back to the left.

The Economic Way of Thinking

Twelfth Edition

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The Economic Way of Thinking

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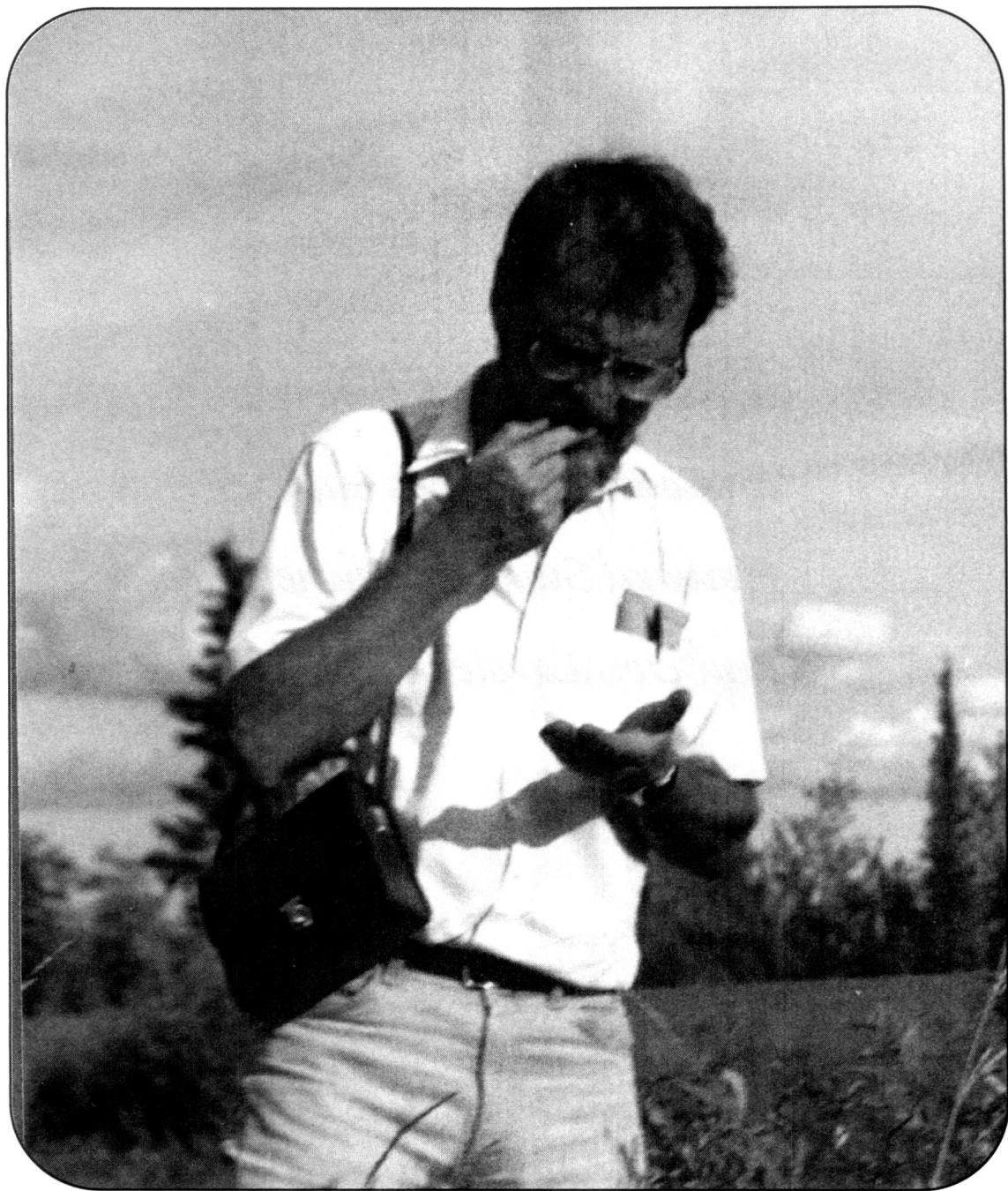
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The Economic Way of Thinking

*In memory of Paul Heyne,
and our professors Hans Sennholz,
Howard Swaine, Kenneth Boulding,
and Don Lavoie*



Paul Heyne
1931–2000

A Tribute

On a rare occasion, if you are fortunate, you will run across an individual who lives and acts upon the ideals that we profess. I was fortunate. Paul Heyne came into my life in 1975. Out of the blue, he sent me a letter that began as follows:

I'm going to be moving to Seattle at the end of the current academic year, and I'd like to find a college or university in the city at which I could be an economics teacher. Those are two separate decisions. I'll be moving to Seattle whether or not I find a position in an economics department there. But teaching and especially the teaching of introductory economics is one of the things I think I do well and something I would continue doing.

I had assumed the chairmanship of the department of economics at the University of Washington in 1967 and set out to make it one of the best in the country. My definition of best included not only scholarly eminence, which we were in the process of achieving, but the effective, caring teaching of the multitude of undergraduates that populated a large state university. The University played lip service to good teaching but the reward system was geared to publication and most, but not all, of my colleagues acted accordingly. Shortly after assuming the chairmanship, I decided I should go back to teaching the introductory course to see just what we did. I was dismayed to find that it had not changed an iota from my undergraduate days. The textbooks were full of the formal jargon of economic theory elucidating the perfectly competitive model, imperfect competition a la Chamberlin and Joan Robinson, and monopoly replete with all the marginal analysis and appropriate graphs. Following the tradition, I was in the midst of my fourth lecture on perfect competition, illustrating it with the case of American agriculture, when a student in the back of the auditorium noisily took exception to what I was saying. I thought I would teach him a lesson and invited him to address the class, explaining himself. He did, describing effectively the myriad of price supports, milk marketing acts, sugar production subsidies, etc. that pervaded agriculture and made it far from the competitive model. I slunk back to my office and began a search for a more effective teaching program. I was some years into an attempt when Paul's letter arrived. I wrote back asking what he would like to do as a teacher. His reply, in part:

I would like to teach at a college whose faculty was enthusiastically committed to providing a liberal education for undergraduates. I would like to be a member of a faculty that was continuously asking about the nature and significance of liberal education and looking critically at its own efforts to provide one. The members of

such a faculty would use their own disciplines as bases for venturing into other disciplines and not as castles within which to enjoy untroubled lives. In the college of my fantasies, there would be some core requirements for all to satisfy; not so much because anyone can specify particular knowledge that a liberally educated person must have as because a liberal arts college requires some common core if it wants to be a lively intellectual community, Mastery of the core would be expected first of all of faculty members. (I've often thought how much more profitable faculty curriculum discussions would be if every faculty member knew that he would be taking all courses imposed on undergraduates and that his colleagues would be evaluating any course he himself wanted to offer in the common core.)

Paul left a tenured professorship at Southern Methodist University to come to Washington as a non-tenured lecturer and he retained that untenured rank until he died in March 2000. I am not sure we lived up to Paul's fantasies of the ideal faculty; I know we didn't but he did change the way economics was taught at the University; revamping the undergraduate program, overhauling the introductory course, and meeting regularly with the graduate teaching assistant to improve the quality of their teaching. But much more than that, Paul was a continuing inspiration for those of us who took seriously a quality liberal education for undergraduates.

The Economic Way of Thinking embodies Paul's approach to economics and to a liberal education. It was a radical change from the textbooks of the time. Its focus on the problems of a society and the way in which economic reasoning could shed light on those problems made economics interesting to the students. More than that, the book recognized that the strength of economics was precisely described in the title of the book—as a way of thinking. Comprehending that way of thinking was, and continues to be, the revolutionary contribution of economics to the social sciences and to a better understanding of the world around us.

I open the seminar for freshmen that I teach every fall with a lecture on Paul, the human being—his Seminary education, ordination, the way he got drawn into economics, and the way he combined a rigorous economics (and make no mistake about it, Paul's economics is rigorous) with a broad and active concern for community and social welfare. He believed in individual freedom and the demands that that freedom imposed on responsible human beings. And he and his wife, Julie, lived their lives accordingly.

A handwritten signature in black ink, reading "Douglass C. North". The signature is fluid and cursive, with the first name "Douglass" written in a larger, more prominent script than the last name "North".

Douglass C. North
Washington University, St. Louis
Nobel Prize in Economic Sciences 1993

Preface

The Economic Way of Thinking continues to enjoy a dedicated and growing following and has been recently translated into Chinese, Japanese, Russian, and Hungarian. Even in English, this book looks different, feels different, and reads different compared with the mainstream fare.

Indeed, this book *is* different.

This text introduces students to the skills of the economist. It teaches students through example and application. It even teaches by showing students how *not* to think, by exposing them to the errors implicit in much popular reasoning about economic events. The text is designed primarily for a one-semester survey course in general economics. It has also been successfully used in M.B.A. economics courses and in Master's courses in economic education. Some have used it as a micro principles text. *The Economic Way of Thinking* develops the basic principles of micro- and macroeconomic analysis and rigorously employs them as *tools* rather than ends unto themselves.

Authors of other introductory texts, understandably eager to display the formal beauty of economic analysis, unwittingly tend to overload students with abstract technical details. Yes, economists build models (and we also use metaphors and rhetoric). But the typical college freshman probably won't share our excitement over the models. Most sit through our courses merely hoping to get a prerequisite out of the way. We economists ought to show them why they're in the seats and we're at the podium. Let's show them why others who have designed the curriculum believe economics is an important area of study. In the end, economics is *not* about production functions, perfectly competitive equilibrium, price takers, or Phillips curves. Instead, economics explores the logic of both the economizing process and the exchange process—it's about plan coordination among buyers and sellers in the world outside the lecture hall. Students using this book will not have to wait for that message at the end of the semester. They'll get it at the very beginning too.

Paul never shied away from making his strategy explicit. In previous editions, he insisted, "We must show them from the first day how the principles of economics make sense out of buzzing confusion; how they clarify, systematize, and correct the daily assertions of newspapers, political figures, ax grinders, and coffee shop pontificators." For more than thirty years, *The Economic Way of Thinking* has taught

students how to see through the nonsense and begin to understand the complex world around them. The 12th edition continues that tradition.

Accomplishing More with Less

This text accomplishes more—more thinking, more application, more insight—with less emphasis on formal modeling. But don't get us wrong. This is not an easy and watered-down exploration of economics. The 12th edition offers a solid discussion and development of economic principles, and a wealth of probing, illuminating applications to the everyday world around us. Even professional economists have informed the co-authors that they have learned more about economics by reading this book. And that's after they've acquired their Ph.D.s.

This book is designed to develop our students' skills in *thinking* like an economist. If they become hooked, they will have ample opportunity to hone their modeling skills as they advance to other economics course offerings. May we hope that the students continue their pursuit of this wonderful discipline—or at least retain its basic lessons.

Changes to the Twelfth Edition

The Economic Way of Thinking is Paul Heyne's baby, his pedagogical legacy. It is richly steeped in the property-rights and coordinationist tradition of Alchian & Allen's *University Economics*, which is long out of print. Our text also has an Austrian-School flair, emphasizing the dynamic, entrepreneurial nature of the market process, themes developed by Ludwig von Mises, F.A. Hayek, Israel Kirzner, and Murray Rothbard. These and other insights—such as the Public Choice approach of our former professors James Buchanan and Gordon Tullock, and the Monetary Equilibrium theory of Gunnar Myrdal—are further developed in this new edition.

Many texts are revised with the mere goal of reentering a tight and competitive market every three years. That, we feel, is the easy way out. We have added value to the 12th edition:

Acknowledgments

We shall always be indebted to the late Paul Heyne. We are thankful that new generations of students continue to have the opportunity to learn from Paul's text.

So many people have helped shape and improve this text over the past three decades. We sincerely think the 12th edition is

the best edition yet. In appreciation, we wish to continue to acknowledge those who have reviewed or offered helpful unsolicited comments on earlier editions, as Paul Heyne did without fail. They are:

Terry Anderson	Joseph Furhig	Marilyn Orozco
Yoram Barzel	Andrew Hanssen	E.C. (Zeke) Pasour
Robert Beck	Robert Higgs	Potluri Rao
Robert Bish	P.J. Hill	Reed Reynolds
Walter Block	Ted Holmstrom	Andrew Rutten
Samuel Bostaph	Laurie Johnson	Haideh Salehi-Esfahani
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Ronald Brandolini	Edward A. Kaschins	Howard Swaine
Paul Briggs	Ronald Krieger	James Swofford
Henry Bruton	Charles Lave	Peter Toumanoff
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Shawn Carter	Frank Machovec	T. Norman Van Cott
Judith B. Cox	John McArthur	Donald Wells
Arthur DiQuattro	Mark McNeil	Sidney Wilson
John B. Egger	Tom Means	Michelle Wyrick
Theo Eicher	Howard Miller	Harvey Zabinsky
Mary Eysenbach	Glenn Moots	M.Y. (Zak) Zaki
Horst Feldmann	Charles Nelson	

In a market economy, mismanaged property rights tend to move into more productive hands, so your authors have quite the incentive to minimize errors and add value to the project. Information, nevertheless, remains a scarce good, so we welcome your comments, criticisms, and suggestions. We've received helpful, unsolicited comments covering errors and typos in the previous text and its supplements from:

Brent Davis	Steve Horwitz	Wendy Warcholik
Matthew Facas	David Johnson	
Warren Gibson	Thomas Swayne	

Always feel free to email Boettke (pboettke@gmu.edu) or Prychitko (dprychit@nmu.edu) for comments on this new edition and its supplements.

Reviewers solicited for the 12th edition provided clear and detailed comments, and challenged us to reconsider examples,

sections, and even whole chapters from the previous edition. They deserve a special word of thanks:

Robert Beck (New Mexico State University)	Robb Freeman (Eastern Maine Community College)
Samuel Bostaph (University of Dallas)	Warren C. Gibson (San Jose State University)
Robert Brown (California State University, San Marcos)	John McArthur (Wofford College)
Shawn Carter (Jacksonville State University)	T. Norman Van Cott (Ball State University)
Paul F. Cwik (Mount Olive College)	Benjamin Powell (Suffolk University)

You've probably noticed that several of our reviewers have been involved with this textbook for quite some time. In our blind review, we have carefully considered all the comments and, when reviewer suggestions offered two (or three) alternative forks in the road, we chose the one we thought would be most interesting and productive. That means we faced opportunity costs and probably won't satisfy all of our reviewers all of the time, but we've tried to do our best.

We don't want to forget GMU grads Scott Beaulier, Chris Coyne, Isaac Dilanni, Jeremy Horpedahl, Peter Leeson, Nick Schandler, and John Robert Subrick who had, at one time or another, a hand in tracking down and updating data since we came on board with the 10th edition. Peter Lipsey, Boettke's personal assistant, did a fine job running in this direction, helping us update the data, proof the copy-edits, and meet our deadlines. Emily and Sonja Prychitko helped their old man at home with technical computer challenges and word processing assistance while trying hard not to laugh at his goofy antics.

Turning to the editorial and production staff, we thank Eric Svendsen (Editor in Chief) and Chris Rogers (Acquisitions Editor) at Prentice Hall for continuing to appreciate this text's uniqueness and for encouraging us to further adapt the new edition to our economic challenging times. We thank Susie Abraham (Assistant Editor), Valerie Patruno (Editorial Assistant), Judy Leale (Managing Editor), and Debbie Ryan (Project Manager) who chuckled at our jokes during our earliest conference calls and then encouraged us to forge ahead as they gracefully fielded our overly stressed and anxiety-ridden emails toward the end of the revision. A shout-out also goes to Sharon Anderson at BookMasters, Inc., for keeping us on top of copyedits and proofreading.

We are grateful to the good people at the Atlas Foundation, Earhart Foundation, J. M. Kaplan Fund, and the Mercatus Center for providing us quite generous financial support for our research and teaching activities over the years, activities that continue to support this new edition as well.

Finally, an acknowledgment that always requires repeating: Pete thanks his wife Rosemary and sons Matthew and Stephen, and Dave thanks his wife Julie and kids Sonja, Emily, Anthony, and Anna. This project would not have meaning if it weren't for their love, support, and understanding.

We like economics, but we *love* our families, although it might not always appear that way at the margin.

Pete Boettke & Dave Prychitko

About the Authors

Peter Boettke is the BB&T Professor for the Study of Capitalism at the Mercatus Center and a University Professor of Economics at George Mason University. Professor Boettke is the author of several books on the history, collapse, and transition from socialism in the former Soviet Union, as well as books and articles on the history of economic thought and methodology.

David L. Prychitko was a Junior Fellow at Cornell University, Fulbright Researcher in Yugoslavia, and Cecil and Ida Green Chair in Economics at Texas Christian University. Also an author of several books and articles on Marxism, comparative systems, and economic methodology, Professor Prychitko currently teaches at Northern Michigan University, his alma mater in the beautiful Upper Peninsula of Michigan.

Close friends (who still occasionally disagree on details), Boettke and Prychitko have published many joint works since graduating from George Mason University in the late 1980s. They have been teaching economics for a combined total of fifty years. They maintain an independent blog appropriately titled “The Economic Way of Thinking” (www.ewot.typepad.com).

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