

STUDY GUIDE TO ACCOMPANY McCONNELL

**ROBERT C.
BINGHAM**

TENTH EDITION

FINANCIAL ACCOUNTING

Study Guide
to Accompany
McConnell
Economics

TENTH EDITION

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Study Guide to accompany McConnell: Economics

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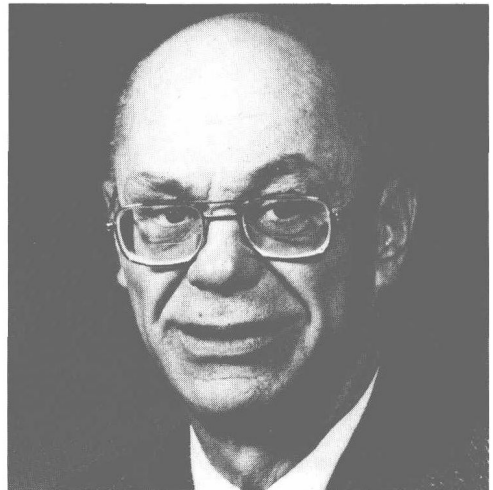
Still to POK

About the author

A week before Bob Bingham was to complete his work on the tenth edition of this study guide we learned that he had suffered a fatal heart attack. The following day we received in our express mail the final batch of manuscript, including the following author's biography.

Robert C. Bingham was an undergraduate student at DePauw University and obtained M.A. and Ph.D. degrees from Northwestern University. He taught at the University of Nebraska—Lincoln where he was a colleague of Professor McConnell before coming to Kent State University from which he retired in 1985. He is the author of several other study guides and supplements for the principles of economics courses. Now that he is retired he teaches only one semester a year; works harder than he did before he retired; and has only a little time left for bridge, military history, and golf.

As he did for every edition, Bob not only met the writing schedules set by his editors, he met his schedules with manuscript written with his love and his skill for teaching to others the things he learned throughout his life.



How to use the Study Guide to learn economics

This *Study Guide* is designed to help you read and understand Campbell R. McConnell's textbook, *Economics*, Tenth Edition. If used properly, a guide can be a great aid to you in what is probably your first course in economics.

No one pretends that the study of economics is easy, but it can be made easier. Of course a study guide will not do your work for you, and its use is no substitute for reading the text. You must be willing to read the text, spend time on the subject, and work at learning if you wish to understand economics.

Many students do read their text and work hard on their economics course and still fail to learn the subject. This is because principles of economics is a new subject for them, and they have had no previous experience in learning economics. They want to learn but do not know just how to go about it. Here is where the *Study Guide* can come to their assistance. Let us first see what the *Study Guide* contains and then how to use it.

■ WHAT THE STUDY GUIDE IS

The *Study Guide* contains forty-four chapters—one for each chapter in the text—an *answer section*, and a *glossary*. Each of the chapters has eight parts.

1. An *introduction* explains what is in the chapter of the text and how its subject matter is related to material in earlier and later chapters. It points out topics to which you should give special attention, and reemphasizes difficult or important principles and facts.
2. A *checklist* tells you the things you should be able to do when you have finished the chapter.

3. A *chapter outline* shows how the chapter is organized and summarizes briefly the essential points made in the chapter.

4. A list of the *important terms* found in the chapter points out what you must be able to define in order to understand the material in the chapter. A definition of each of these terms will be found in the glossary at the end of the *Study Guide*.

5. *Fill-in* questions (short-answer and list questions) help you to learn and remember the crucial and important generalizations and facts in the chapter.

6. *Problems and projects* assist you in learning and understanding economic relationships and get you to think about certain economic problems.

7. *Objective questions* (true-false and multiple-choice) can be used to test yourself on the material in the chapter.

8. *Discussion questions* can be used to test yourself, to identify important questions in the chapter, and to prepare for examinations.

■ HOW TO STUDY AND LEARN WITH THE HELP OF THE STUDY GUIDE

For best results, quickly read the introduction, outline, list of terms, and checklist in the *Study Guide* before you read the chapter in the text. Then read the chapter in the text slowly and keep one eye on the outline and the list of terms. Always read with pencil in hand and use your textbook as if you expected to sell it for wastepaper at the end of the year. The outline in the *Study Guide* contains only the major points in the chapter. Outline the chapter as you read it by identifying the major *and the minor* points

and by placing appropriate numbers or letters (such as I or A or 1 or a) in the margins. It is also wise to underline the major and minor points in the chapter and to circle the important terms. When you have completed the chapter, you will have the chapter outlined and your underlining will give you a set of notes on the chapter. It is not necessary to keep a separate notebook for textbook notes or outlines. Be careful to underline only the really important or summary statements.

After you have read the chapter in the text through once, turn again to the introduction, outline, and list of terms in the *Study Guide*. Reread the introduction and outline. Does everything there make sense? If not, return to the text and reread the topics that you do not remember well or that still confuse you. Look at the outline. Try to recall each of the minor topics or points that were contained in the text under each of the major points in the outline. When you come to the list of terms go over them one by one. Define or explain each to yourself and then look for the definition of the term either in the text chapter or in the glossary. Compare your own definition or explanation with that in the text or glossary. The quick way to find the definition of a term in the text is to look in the index of the text for the page or pages on which that term or concept is mentioned. Make any correction or change in your own definition or explanation that is necessary.

When you have done all this, you will have a pretty fair general idea of what is in the text chapter. Now take a look at the fill-in questions, the problems and projects, and the self-test questions. Tackle each of these three sections one at a time, using the following procedure. (1) Answer as many questions as you can without looking in the text or in the answer section. (2) Check the text for whatever help you need. It is a good idea to do more than merely look for answers in the text. Reread any section for which you were not able to answer questions. (3) Then consult the answer section for the correct answers and reread any section of the text for which you missed questions.

The questions in these three sections are not all of equal difficulty. Do not expect to get them all right the first time. Some are designed to pinpoint things of importance which you will probably miss the first time you read the text and to get you to read about them again. None of the questions is unimportant. Even those that have no definite answers will bring you to grips with many important economic questions and increase your understanding of economic principles and problems.

In answering the discussion questions—for which no answers are given—it is not necessary to write out answers. All you need to do is mentally outline your answer.

For the more difficult discussion questions you may want to write out a brief outline of the answer or a full answer. Do not avoid the difficult questions just because they are more work. Answering these questions is often the most valuable work a student can do toward acquiring an understanding of economic relationships and principles.

Before you turn to the next chapter in the text and *Study Guide*, return to the checklist. If you cannot honestly check off each of the items in the list, you have not learned what the author of the text and of this *Study Guide* hoped you would learn.

■ SOME FINAL WORDS

Perhaps the method of using the *Study Guide* outlined above seems like a lot of work. It is. Study and learning necessarily entail work on your part. This is a fact you must accept if you are to learn economics.

After you have used the *Study Guide* to study three or four chapters, you will find that some sections are of more value to you than others. Let your own experience determine how you will use it. But do not discontinue use of the *Study Guide* after three or four chapters merely because you are not sure whether it is helping you. Stick with it.

In addition to the material in the *Study Guide*, there are questions at the end of each chapter in the text. Some of these questions are similar to questions in the *Study Guide*, but none is identical. It will be worthwhile for you to examine all the questions at the end of each chapter and to work out or outline answers for them. Students who have trouble with the problems in the *Study Guide* will find the end-of-chapter problems useful in determining whether they have actually mastered their difficulties. All students will find many of the end-of-chapter questions more thought-provoking than the discussion questions in the *Study Guide*.

For those of you who either have trouble with or wish to learn more rapidly the sections of the text containing explanations of economic theory (or principles), let me recommend my *Economic Concepts: A Programmed Approach*. A programmed book is a learning device which speeds and increases comprehension. Its use will greatly expand your understanding of economics.

■ ACKNOWLEDGMENTS

The number of people who have helped me with the ten editions of this book is large and I should like to record

their names in print. In addition to the students who made suggestions for improving the guide (often by pointing out the errors that I had made) and the instructors (Thomas Casey and Robert Sharp, in particular) who sent corrections and recommendations to me, Campbell R. McConnell encouraged me; Fred R. Kucera, Francis J. Colella,

Barbara Cunningham-Miller, Richard Hansen, and John Schuman reviewed my work; and Jerry L. Petr produced the behavioral objectives which are the foundation of the checklists found in this *Study Guide*.

Robert C. Bingham

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Contents

How to use the study guide to learn economics vii

An introduction to American capitalism

1 The nature and method of economics	1
2 An introduction to the economizing problem	8
3 Pure capitalism and the circular flow	16
4 The mechanics of individual prices: demand and supply	20
5 The price system and the Five Fundamental Questions	29
6 Mixed capitalism and the economic functions of government	35
7 The facts of American capitalism: the private sector	45
8 The facts of American capitalism: the public sector	51

National income, employment, and fiscal policy

9 National income accounting	59
10 Macroeconomic instability: unemployment and inflation	68
11 Macroeconomics: an overview	77
12 Classical and Keynesian theories of employment	86
13 Equilibrium national output in the Keynesian model	98
Appendix to Chapter 13: International trade and equilibrium output	109
14 Fiscal policy	114
15 Budget deficits and the public debt	126
16 Inflation, unemployment, and aggregate supply	134

Money, banking, and monetary policy

17 Money and banking	147
-----------------------------	-----

18 How banks create money	155
19 The Federal Reserve Banks and monetary policy	163
20 Alternative views: monetarism and rational expectations	174

Economic growth: analysis and policy

21 The economics of growth	183
22 Economic growth: facts and issues	191
23 Growth and the underdeveloped nations	199

The economics of the firm and resource allocation

24 Demand, supply, and elasticity: some applications	208
25 Further topics in the theory of consumer demand	217
Appendix to Chapter 25: Indifference curve analysis	222
26 The costs of production	228
27 Price and output determination: pure competition	238
28 Price and output determination: pure monopoly	248
29 Price and output determination: monopolistic competition	256
30 Price and output determination: oligopoly	262
31 Production and the demand for economic resources	271
32 The pricing and employment of resources: wage determination	280
33 The pricing and employment of resources: rent, interest, and profits	290
34 General equilibrium: the price system and its operation	299

x CONTENTS

Current economic problems

35	Antitrust and regulation	307
36	Rural economics: the farm problem	316
37	Urban economics: the problems of the cities	328
38	Income distribution: inequality, poverty, and discrimination	336
39	Labor unions and their economic impact	346
40	The radical critique: the economics of dissent	355

International economics and the world economy

41	International trade: comparative advantage and protectionism	363
42	Exchange rates and the balance of payments	373
43	International economic issues	386
44	The economy of the Soviet Union	394
	Answers	403
	Glossary	429

1

The nature and method of economics

Chapter 1 introduces you to the study of economics. Its aim is to explain the subject matter of economics and the methods economists employ in the study of this subject matter.

While this chapter indicates the value to be derived from the study of economics and the importance of economic questions and problems to every individual, the heart of the chapter is the discussion of economic principles. Economic principles are generalizations based on facts; but, because the economist cannot employ laboratory experiments to test his generalizations, these principles are always imprecise and subject to exceptions. Economics is a science but it is not an exact science.

If the study of economics is to be of any worth to you, it is necessary to understand from the very beginning that economic principles are simplifications—approximations of a very complex real world—and that both the formulation and application of these principles present many opportunities for the making of serious mistakes. Economic principles are not the answers to economic questions but are tools—intellectual tools—for analyzing economic problems and finding policies to solve these problems. Selection of the economic policies to follow depends not only upon economic principles but also upon the value judgments of society—that is, upon the goals of the economy.

Pages 11 to 14 of the textbook outline a few of the many errors of commission and omission of which the beginner in economics ought to beware. The study of economics is difficult enough without compounding the difficulty with emotional, logical, and semantical errors.

■ CHECKLIST

When you have studied this chapter you should be able to:

- ☐ Write the formal definition of economics.
- ☐ Give two (allegedly) good reasons for studying economics.
- ☐ Define descriptive economics.
- ☐ Explain what an economic principle is and how economic principles are obtained.
- ☐ List the two important characteristics of every economic principle and explain each of these characteristics.
- ☐ Explain what the “other things equal” (*ceteris paribus*) assumption is and why this assumption is employed in economics.
- ☐ Accurately construct a graph of two variables based on numerical data presented to you.
- ☐ Explain what an economic policy is.
- ☐ Identify the seven economic goals.
- ☐ Recognize the “pitfalls to straight thinking” when confronted with examples of them.

■ CHAPTER OUTLINE

1. Economics is concerned with efficiently utilizing limited productive resources to achieve the maximum satisfaction of human material wants.
2. Citizens in a democracy must understand elementary economics in order to understand the present-day prob-

lems of their society and to make intelligent decisions when they vote. Economics is an academic rather than a vocational subject, but a knowledge of it is valuable to business executives, consumers, and workers.

3. Economists gather relevant facts to obtain economic principles that may be used to formulate policies which will solve economic problems.

a. Descriptive economics is the gathering of relevant facts about the production, exchange, and consumption of goods and services.

b. Economic theory is the analysis of the facts and the derivation of economic principles.

(1) Economic principles are also called laws, theories, and models.

(2) Each of these principles is a generalization.

(3) Economists employ the *ceteris paribus* (or "other things equal") assumption to obtain these generalizations.

(4) These principles are also abstractions from reality.

(5) To obtain and test their principles economists use both the inductive and the deductive method.

(6) Economists express their principles or models not only with words, tables, and equations but with graphs.

(7) Economic models can be quite useful; but there are at least three dangers in building and using them.

c. Policy economics is the combination of economic principles and economic values (or goals) to control economic events.

(1) Values are the judgments people make about what is desirable (good, just) and what is undesirable (bad, unjust).

(2) The American society appears to have at least seven major economic goals; but several of these goals are mutually exclusive.

(3) There are three steps in creating a policy designed to achieve an economic goal.

d. To recapitulate, finding a public policy that will lead to the solution of a particular social problem requires that economists develop principles based on facts found in the world of reality.

4. Straight thinking in the study and use of economic principles requires strict application of the rules of logic in which personal emotions are irrelevant, if not detrimental. The pitfalls encountered by beginning students in studying and applying economic principles include:

a. bias or preconceived beliefs not warranted by facts;

b. loaded terminology or the use of terms in a way which appeals to emotion and leads to a nonobjective analysis of the issues;

c. the definition by economists of terms in ways which may not be the same as the ways in which these terms are more commonly used;

d. the fallacy of composition or the assumption that what is true of the part is necessarily true of the whole;

e. the belief that what is true or valid during a depression is, therefore, true or valid during a period of prosperity (and vice versa);

f. and the *post hoc fallacy* or the mistaken belief that when one event precedes another that the first event is the cause of the second.

■ IMPORTANT TERMS

Descriptive economics	Applied (policy) economics
Economic principles (law)	Economic policy
Economic theory (analysis)	Value judgment
Generalization	Mutually exclusive goals
Economic model	Loaded terminology
Abstraction	Fallacy of composition
"Other things equal" (<i>ceteris paribus</i>) assumption	Macroeconomics
Directly related	Microeconomics
Inversely related	<i>Post hoc, ergo propter hoc</i> fallacy
Induction	Correlation
Deduction	Causation

■ FILL-IN QUESTIONS

1. Economics as a subject:
a. Is, first of all, the study of the

_____ ,
_____ ,

and _____
of the material goods and services that satisfy human wants.

b. But, more formally, it is concerned with the efficient utilization of _____ productive resources to achieve the _____ satisfaction of these wants.

2. An understanding of economics is essential if we are to be well-informed _____ and it has many personal applications even though it is an academic and not a _____ subject.

3. Economics, like other sciences, begins with the facts found in the world around us. The gathering of relevant economic facts is the part of economics called _____ economics.

4. The economic principles (often called theories, laws, or models) derived from facts are all _____ about man's economic behavior and as such necessarily involve _____ from reality.

5. Economists know that the amount consumers spend for goods and services in any year depends upon their after-tax income in that year and several factors other than their income. To look at the relationship between the spending and income of consumers, economists often assume that these other factors are constant and do not change; and when economists do this they make the _____ assumption.

6. What three dangers are inherent in the construction and application of economic models?

- a. _____
- b. _____
- c. _____

7. Economic principles enable the economist to predict the result of a certain economic act or of certain economic behavior; this ability to predict is valuable because it makes it possible frequently to _____ economic events or, at least, to _____ for them.

8. Seven widely accepted economic goals in the United States are the following:

- a. _____
- b. _____
- c. _____
- d. _____
- e. _____
- f. _____
- g. _____

9. The three steps involved in the formulation of economic policy are:

- a. _____
- b. _____
- c. _____

10. Macroeconomics is concerned with the _____

output of the economy and the _____ level of prices, while microeconomics is concerned with output in a(n) _____

and the price of a(n) _____

■ PROBLEMS AND PROJECTS

1. "In 1982 the Russian demand for wheat in the United States increased and caused the price of wheat throughout the United States to rise." This is a *specific* instance of a more *general* economic principle. Of which economic *generalization* is this a particular example? _____

2. Below are four statements. Each of them is an example of one of the pitfalls frequently encountered in the study of

economics. Indicate in the space following each statement the type of pitfall involved.

a. "Thrift (or saving) promotes the welfare of the economy." _____

b. "An unemployed worker can find a job if he looks diligently and conscientiously for employment; therefore, all unemployed workers can find employment if they are diligent and conscientious in looking for a job." _____

c. *Bingham*: "Regulation of public utilities in the United States is an immoral and unconscionable interference with the God-given right of private property and, as you know, old chum, there is no private property in the communist states." *McConnell*: "It is far from that, my boy. You know perfectly well that it is an attempt to limit the unmitigated avarice of mammoth corporations in order, as the Constitution commands, to promote the general welfare of a democratic America." _____

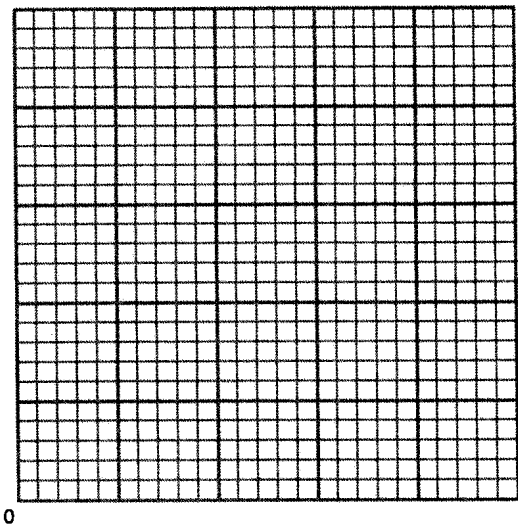
d. "The stock market crash of 1929 was followed by and resulted in 10 years of Depression." _____

3. Below are three exercises in making graphs. On the graphs plot the economic relationships contained in each exercise. Be sure to label each axis of the graph and indicate the unit of measurement and scale used on each axis.

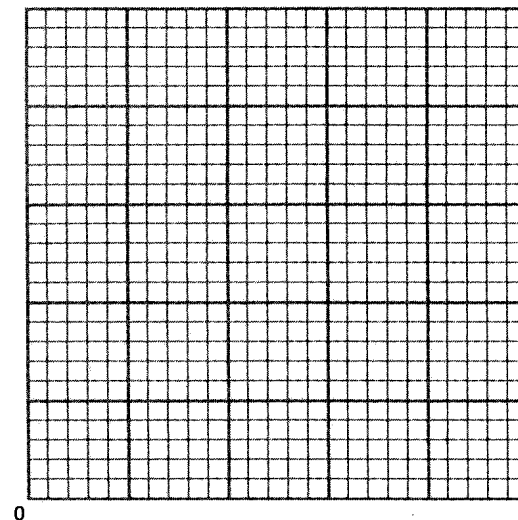
a. Graph national income on the horizontal axis and consumption expenditures on the vertical axis; connect the seven points and label the curve "Consumption Schedule." The relationship between national income and consumption expenditures is a(n) (direct, inverse)

_____ one and the Consumption Schedule a(n) (up-, down-) _____ sloping curve.

National income, billions of dollars	Consumption expenditures, billions of dollars
\$ 600	\$ 600
700	640
800	780
900	870
1000	960
1100	1050
1200	1140



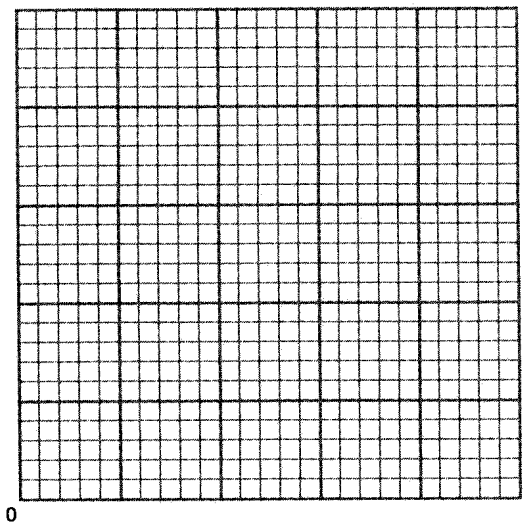
b. Graph investment expenditures on the horizontal axis and the rate of interest on the vertical axis; connect the seven points and label the curve "Investment Schedule." The relationship between the rate of interest and investment expenditures is a(n) _____ one and the Investment Schedule is a(n) _____ sloping curve.



Rate of interest, %	Investment expenditures, billions of dollars
8	\$220
7	280
6	330
5	370
4	400
3	420
2	430

c. Graph average salary on the horizontal axis and whisky consumption on the vertical axis; connect the seven points.

Average salary, American college professors	Annual per capita whisky consumption in the U.S., gal.
\$32,000	1.5
33,000	1.6
34,000	1.7
35,000	1.8
36,000	1.9
37,000	2.0
38,000	2.1



(1) The average salary of a college professor and whisky consumption (are, are not) _____ *correlated*; and the higher average salary (is, is not) _____ the *cause* of the greater consumption of whisky.

(2) The relationship between the two variables may be purely _____; or, as is more likely, both the higher salaries and the greater consumption of whisky may be the result of the higher _____ in the American economy.

■ SELF-TEST

Circle the *T* if the statement is true; and *F* if it is false.

1. Economics deals with the activities by which humans can earn a living and improve their standard of living. **T F**
2. Economics is academic and of little value because it does not teach the student how to earn a living. **T F**
3. Gathering the relevant economic facts from which economic principles are derived is the part of economics called economic analysis. **T F**
4. In economics the terms "law," "principle," "theory," and "model" mean essentially the same thing. **T F**
5. The "other things equal" or *ceteris paribus* assumption is made in order to simplify the reasoning process. **T F**
6. The deductive method is the scientific method and the method used to derive economic principles from economic facts. **T F**
7. Economic principles enable us to predict the economic consequences of many human actions *and* to control (or prepare for) the occurrence of undesirable events. **T F**
8. One of the widely (though not universally) accepted economic goals of Americans is an equal distribution of income. **T F**
9. The first step in the formulation of an economic policy, the statement of the goal or desired result, may be an occasion for disagreement because different people may have different and conflicting goals. **T F**