



**STUDY GUIDE TO ACCOMPANY MABRY•ULBRICH**

INTRODUCTION TO

**ECONOMIC  
PRINCIPLES**

MELLIE WARNER

**STUDY GUIDE TO ACCOMPANY MABRY-ULBRICH**  
**INTRODUCTION**  
**TO ECONOMIC**  
**PRINCIPLES**

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INTRODUCTION TO ECONOMIC PRINCIPLES**

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## PREFACE

The purpose of a study guide is to help you, the student, better understand the text material. At least that is the purpose from the point of view of your professor and this author. From your point of view, the purpose may well be to improve your chances of getting a good grade on your tests and therefore in the course. There is no conflict between these purposes, and I hope this study guide will fulfill them both.

Each chapter of the study guide will review the material from the textbook and provide test questions. These questions will allow you to test yourself and identify weak areas in your knowledge and understanding before your professor does it for you. Such early detection will prompt you to study certain areas again or ask intelligent questions of your professor. The result will be conservation of that especially scarce resource: your professor's time.

There will be completion material with a list of key words to be inserted, as well as multiple choice, true-false and problems/discussion questions in each chapter. Answers are provided at the end of the text. In the completion exercise, a blank that runs over from one line to the next should be filled in with an answer that is more than one word. The author's intent was that all one-word answers have their corresponding blank all on one line. Many words may be used more than once in an exercise. There are no intentionally extra words, but some may have crept in during revisions.

Mellie Warner

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## Chapter 1

### Introduction to Economics

**Summary:** Economics is the study of how choices are made when resources are scarce and uses for the resources are many. Microeconomics concentrates on decision making by individuals. Macroeconomics looks at the performance of the economy as a whole. Everyone is a "practical economist" who must make decisions every day. People study economics because they want to know more about how individuals and economies make decisions.

### Chapter Outline

What is Economics?

- Microeconomics and Macroeconomics

- The Boundaries of Economics

The Practical Economist

- Self-Interested Behavior

- Maximizing

- Responding to Incentives

- Marginal Thinking

Why Study Economics?

Economic Methods and Tools

- Economic Method

  - Stating the Problem

  - Using Economic Models

  - Identifying Solutions

  - Evaluating Solutions

  - Choosing and Implementing Solutions

- Qualifications in Economic Models

  - Assumptions

  - Secondary Effects

  - The Short Run and the Long Run

- Economists' Tools: Graphs and Statistics

  - Graphs

  - Statistics

## Completion Exercise I

Insert the following key words into the text below. Some of them may be used more than once.

aggregate	all	at the margin
average	changes	cost
economics	efficient	individuals
inflation	macroeconomics	maximize
maximizing	microeconomics	minimizing
opportunity cost	practical economist	recessions
relative	resources	satisfaction
scarce	selfishness	unemployment
unlimited	zero	

When resources are \_\_\_\_\_ and their possible uses are \_\_\_\_\_, choices have to be made about where to use them. This is the basic idea behind the science of \_\_\_\_\_. For example, your resources may consist of \$10 in your pocket and four hours on Saturday night. You must decide how best to use those \_\_\_\_\_ so that you get the most \_\_\_\_\_ from them. The value of the next best alternative that you give up is called the \_\_\_\_\_.

Your decision about your time and money falls under the branch of economics called \_\_\_\_\_. \_\_\_\_\_ studies decision-making "in the small." It is concerned with \_\_\_\_\_, both households (or consumers) and businesses. Businesses must decide what goods and service to produce. They must decide which methods of production will be most \_\_\_\_\_--that is how to produce at the least possible \_\_\_\_\_.

Decision-making at the national level comes under the branch of economics known as \_\_\_\_\_. \_\_\_\_\_ is concerned with the overall level of economic activity in all markets. It looks at \_\_\_\_\_ or totals in many markets. The overall level of output of the economy, the level of prices and how fast they are going up, and the rate of \_\_\_\_\_

are all important in macroeconomics. The government has to make decisions about taxes and how to combat \_\_\_\_\_ and \_\_\_\_\_. Economic growth and the policies that promote it are also a part of macroeconomics.

Economists make some simplifying assumptions that help us predict how an \_\_\_\_\_ individual will behave. This individual is called the \_\_\_\_\_ in your text. These assumptions bring economic problems down to a manageable size. The assumptions follow.

**1. Self-Interested Behavior:** The practical economist knows what gives him the most \_\_\_\_\_. He knows whether watching football or playing golf makes him the happiest. Economists don't worry about how the individual developed his likes and dislikes; it is only important that the individual know them himself and act on them. This assumption does not imply \_\_\_\_\_; many people include concern for others in their own preferences.

**2. Maximizing Behavior:** An individual will act so that she gets the most satisfaction possible. Sometimes \_\_\_\_\_ behavior will appear as \_\_\_\_\_ behavior. For example, a firm may be observed to \_\_\_\_\_ its profits by \_\_\_\_\_ the costs of production.

**3. Incentives:** Individuals will respond to \_\_\_\_\_ in incentives. If the price of going to the movies goes up by a dollar, some people will cut back on the number of movies they go to see. If salaries for economists go up \_\_\_\_\_ to those for electrical engineers, more people will become economists. Notice that we do not get a change to \_\_\_\_\_ electrical engineers when the salaries change. Economics does not assume that all people will alter their behavior in response to a change. But on average there will be a change caused by a change in incentives.



4. **Marginal Thinking:** Choices are made \_\_\_\_\_ This means that people do not make all or none decisions. If the price of pizzas goes up by a dollar, you will probably still buy pizzas, but you will buy them less often or perhaps you'll buy a smaller size. You will make a change \_\_\_\_\_ in the amount of pizza you will buy.

## Completion Exercise II

Insert the following key words into the blanks. Some may be used more than once.

adjustment(s)	ceteris paribus	economic method
economic model(s)	graphs	implement
incentives	long run	normative
positive	secondary effects	short run
simplified	state the problem	statistics
solutions		

Economists have a systematic way of approaching a problem. This is called the \_\_\_\_\_. The first step is to \_\_\_\_\_. Then it must be narrowed down to a reasonable size and presented in economic terms. We also have to be careful that we don't make the solution part of the statement of the problem. The next step is to apply an \_\_\_\_\_. Economists have developed numerous \_\_\_\_\_ of behavior and we need to pick the one that best applies to our problem. Our model should indicate some possible \_\_\_\_\_ to our problem. These will usually be in the form of changes in \_\_\_\_\_. If we want to encourage a behavior, we want to increase the reward or at least people's knowledge of the reward to that behavior. If we want to discourage a behavior, we want to increase the penalties or costs, or at least the awareness of the penalties.

Next, the solutions must be evaluated and a decision made about which to \_\_\_\_\_. The different solutions will have different costs and different rates of effectiveness. They will probably affect different groups by different amounts. An important thing to remember in evaluating policies is that they may have \_\_\_\_\_. These may be small or big, but it is important to keep them in mind.

The final step is to choose and implement a solution. Now the work has moved into the area of the policy analyst or politician. Economists usually limit themselves to \_\_\_\_\_ statements. These statements tell us what is or what will happen; they do not make value judgements. They do not tell us which thing is more desirable. Politicians and policy analysts are free to make \_\_\_\_\_ statements. These involve a value judgement such as "We would be better off spending more money on schools and less on defense." The vast majority of economists make a conscious effort to make their professional analysis independent of their personal preferences.

We need to understand what qualifications an economist puts on his models and predictions. An economist studies a problem at a particular point in time--like taking an instant photo. Nothing else is allowed to change. This is formally called \_\_\_\_\_ which means everything else being equal. This is the most important assumption an economist makes, but can lead to errors because in the real world things rarely remain the same for long.

Economists talk about events in two time frames--the \_\_\_\_\_ and the \_\_\_\_\_. The predictions out of a given model can vary depending on which time frame you are dealing in. The two do not refer to a particular length of time, but to the time needed for \_\_\_\_\_ to changes in \_\_\_\_\_. In the \_\_\_\_\_ some things can adjust, but not all of the important things. In the \_\_\_\_\_ everything can adapt to the new conditions. It is important to distinguish \_\_\_\_\_ and \_\_\_\_\_ predictions.

Two principal tools of economists are \_\_\_\_\_ and \_\_\_\_\_. \_\_\_\_\_ are a way to simplify a problem by drawing a picture. \_\_\_\_\_ are equally important. Economists like to be able to measure things. Price

and quantity are the two most important measures an economist uses. Prices are important because they signal changing \_\_\_\_\_.

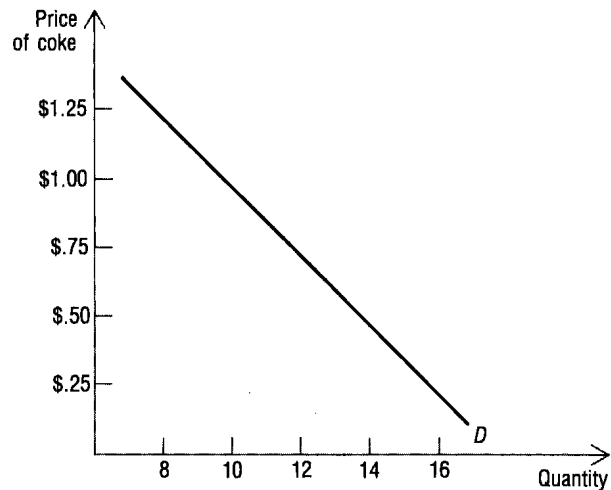
#### Problems/Discussion Questions

1. Mandy has been invited to go skiing over Spring Break. It will cost her \$200 to go. If she doesn't go skiing, she can go home and work at her father's store and earn \$200. What is the opportunity cost of going skiing? Why?

2. The U.S. Naval Academy has a no cut rule for class attendance. A midshipman who misses a class without an acceptable excuse is required to spend 5 weekends on campus. Your university has decided that it wants students to attend classes more regularly. It could adopt a system like the Naval Academy's or look for other solutions. What are some other possible solutions? Would the Naval Academy's solution work at a place like your university? Why or why not? Evaluate your possible solutions and decide which would work best at the least cost.

3. When the price of gasoline went up sharply in 1973 and 1974, our practical economist continued to drive her 1973 Cadillac even though it only got 12 miles to the gallon. In 1979 she traded it in for a Toyota that gets 30 miles to the gallon. In 1972 she drove 15,000 miles. In 1975 she drove 9,000 miles. In 1980 she drove 15,000 miles. What was the short run adjustment that she made to the increased price of gasoline? What was the long run adjustment that she made? Why do you think she waited to make the long run adjustment?

4. Look at the following graph and answer the questions.



- If Coke costs \$.50, how many will be bought each week?
- At what price will the consumer be willing to purchase 10 per week?
- At what price will the consumer be willing to purchase 12 per week?
- If Coke costs \$.75, how many will be bought each week?
- What law of economics is illustrated by the graph?

## Multiple Choice Questions

1. Economics is the study of
  - a. the American political system.
  - b. decision-making by individuals and society.
  - c. decision-making by politicians.
  - d. unlimited resources and scarce wants.
  - e. unpopular choices in Washington.
2. Microeconomics is the study of
  - a. unemployment rates and inflation rates.
  - b. decision-making by specific individuals.
  - c. decision-making by the average individual or firm.
  - d. how the government affects individuals.
3. The opportunity cost of any choice is
  - a. all the other opportunities that were foregone.
  - b. the worst opportunity that was foregone.
  - c. the opportunity that couldn't quite be attained.
  - d. the next best alternative that was foregone.
4. Choices are necessary because
  - a. resources are scarce.
  - b. people are greedy.
  - c. people are poor.
  - d. wants are unlimited.
  - e. both a. and d.
5. "If we raise the tax on beer, there will be less beer sold." This is an example of
  - a. a positive statement.
  - b. a normative statement.
  - c. ceteris paribus.
  - d. a macroeconomic statement.
6. The assumption of self-interested behavior
  - a. means that people are basically selfish and unconcerned with other peoples needs.
  - b. means that people know their own preferences and act on them.
  - c. is unnecessary for most of economic theory.
  - d. means that it is necessary for people to make choices about their scarce resources.
7. Economists believe that if you change an incentive
  - a. every individual will change her behavior.
  - b. all individuals will change their behavior, but only in the long run.
  - c. no one will change their behavior because incentives are unimportant.
  - d. the average individual will change his behavior.

8. Which of the following is an example of a marginal response?
- a. When the price of Coca-Cola went up, Bob stopped drinking it.
  - b. When the price of Coca-Cola went up, Mary ordered water more often with her meals.
  - c. When the price of video rentals declined, Sarah stopped going to the movies.
  - d. When the lines in the cafeteria got longer, Mike decided not to get a meal ticket for the next semester.
9. Economic models
- a. are useful simplifications of the real world.
  - b. are useless because they are oversimplified.
  - c. are too abstract for the average person to understand.
  - d. allow economists to make predictions about average behavior.
  - e. both a. and d.
10. A normative statement
- a. states a fact.
  - b. contains one or more logical errors.
  - c. is the same as a positive statement.
  - d. contains a value judgement.
  - e. is part of the main job of economists.
11. The ceteris paribus assumption
- a. means that all other things are held constant.
  - b. means only the relevant things are allowed to change.
  - c. is not very important in economics.
  - d. means that we are dealing with the short run.
  - e. means that we dealing with the long run.
12. In the long run
- a. only the relevant variables are allowed to change.
  - b. all variables can change.
  - c. only a few variables can change.
  - d. decisions are less important than in the short run.



### True-False Questions

- \_\_\_\_\_1. Economics has been defined as "the study of mankind in the ordinary business of life."
- \_\_\_\_\_2. Economists are generally gloomy about the state of the world. (After all, economics is known as the "dismal science.")
- \_\_\_\_\_3. Economics is the science of making choices.
- \_\_\_\_\_4. Choices must be made because of scarcity.
- \_\_\_\_\_5. When economists refer to scarce resources they are only referring to money.
- \_\_\_\_\_6. The next best alternative foregone when a decision is made is called the opportunity set.
- \_\_\_\_\_7. The question of how a tax increase on the consumption of cigarettes will affect the number of cigarettes consumed is basically macroeconomic in nature.
- \_\_\_\_\_8. The question of how an increase in the income tax will affect the overall level of output in the economy is basically macroeconomic in nature.
- \_\_\_\_\_9. Economic principles can be applied to almost any kind of decision-making process such as deciding whether or not to get married.
- \_\_\_\_\_10. The practical economist can tell you at any given moment if she prefers apples to oranges.
- \_\_\_\_\_11. If Sally goes to the grocery store to get a nutritious dinner for the minimum cost, she can be said to be using maximizing behavior.
- \_\_\_\_\_12. The two most important economic incentives are prices and quantities.
- \_\_\_\_\_13. When the government publicizes the bad effects of cocaine use, it doesn't have any effect on peoples' incentives to use drugs.
- \_\_\_\_\_14. Sean bought a soda every day when the price was 40 cents. Now that sodas cost 50 cents he only buys 5 sodas each week. This is an example of making a change at the margin.