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# 1

## PART ONE

### An Introduction to Economics and the Economy

## TO THE STUDENT

Economics is largely concerned with efficiency—accomplishing goals using the best methods. Several features of this book and its ancillaries are designed to improve your efficiency in learning economics (and therefore your course grade):

- **Appendix on graphs** Being comfortable with graphical analysis and a few quantitative concepts is a big advantage in understanding principles of economics. The appendix to Chapter 1 reviews graphing, line slopes, and linear equations. Be sure to not skip it.
- **Introductions** The introductory paragraphs of each chapter place the chapter in the proper context, state its main objectives, and tell you how it is organized. These introductions lead you into the economic analysis.
- **Terminology** A significant portion of any introductory course is terminology. Key terms are set in **boldface type**, listed at the end of each chapter, and defined in the glossary at the end of the book.
- **Reviews** Important things should be said more than once. Each chapter contains a summary and two or three Quick Reviews. These reviews will help you focus on essential ideas and study for exams. If any review statement seems unclear, you should reread the corresponding section of the text.
- **Key Graphs** Graphs that have special relevance are labeled Key Graphs, and each includes a multiple-choice Quick Quiz. Your instructor may or may not emphasize all these figures, but you should pay special attention to those that are discussed in class; you can be certain that there will be exam questions on them.
- **Figure legends** The legends accompanying the figures in this book are self-contained analyses of the figures. Study these legends carefully—they are quick synopses of important ideas.
- **Globalization** The economics of individual nations are becoming part of an overall global economy. To gain appreciation of this wider economic environment, be sure to take a look at the Global Perspectives, which compare the United States to other selected nations.
- **Last Words** Each chapter concludes with a Last Word minireading. While it is tempting to ignore these sections, don't. Some of them are revealing applications of economic concepts; others are short case studies. A few present views which contrast with mainstream thinking; and most are fun to read. All will broaden your grasp of economics.
- **Questions** A comprehensive list of questions is located at the end of each chapter. The old cliché that you “learn by doing” is very relevant to economics. Answering these questions will enhance your understanding. Several of the questions are designated as Key Questions and are answered in the *Study Guide* and the *Instructor's Resource Manual*, and they can also be found at our Website, <http://www.mhhe.com/economics/mcconnell>. You can turn to these particular questions when they are cited in each chapter, or later, after you have read the full chapter.
- **Study Guide** We enthusiastically recommend the *Study Guide* accompanying this text. This “portable tutor” contains not only a broad sampling of various kinds of questions but a host of useful learning aids.

You will find in Chapter 1 that economics involves a special way of thinking—a unique approach to analyzing problems. The overriding goal of this book is to help you acquire that skill. If our cooperative efforts—yours, ours, and your instructor's—are successful, you will be able to comprehend a whole range of economic, social, and political problems that otherwise would have remained murky and elusive.



# The Nature and Method of Economics

**H**uman beings, those unfortunate creatures, are plagued with wants. We want, among other things, love, social recognition, and the material necessities and comforts of life. Our efforts to meet our material wants, that is, to improve our well-being or “make a living,” are the concern of economics.

Biologically, we need only air, water, food, clothing, and shelter. But, in contemporary society, we also seek the many goods and services associated with a comfortable or affluent standard of living. Fortunately, society is blessed with productive resources—labor and managerial talent, tools and machinery, land and mineral deposits—which are used to produce goods and services. This production satisfies many of our material wants and occurs through the organizational mechanism called the *economic system* or, more simply, *the economy*.

The blunt reality, however, is that the total of all our material wants is many times greater than the productive capacity of our limited resources. Thus, the complete satisfaction of material wants is impossible. This unyielding reality provides our definition of **economics**: *the social science concerned with the efficient use of limited or scarce resources to achieve maximum satisfaction of human material wants*.

Although it may not be evident, most of the headline-grabbing issues of our time—inflation, unemployment, health care, social security, budget deficits, discrimination, tax reform, poverty and inequality, pollution, and government regulation and deregulation of business—are rooted in the one challenge of using scarce resources efficiently.

In this first chapter, however, we will not plunge into problems and issues; instead, we will discuss some important preliminaries. Specifically, we first look at the economic perspective—how economists think about problems. Next, we state some of the benefits of studying economics. Then we consider the specific methods economists use to examine economic behavior and the economy, distinguishing between macroeconomics and microeconomics. Finally, we examine the problems, limitations, and pitfalls that hinder sound economic reasoning.

## THE ECONOMIC PERSPECTIVE

Economists view things through a unique perspective. This **economic perspective** or *economic way of thinking* has several critical and closely interrelated features.

### Scarcity and Choice

From our definition of economics, it is easy to see why economists view the world through the lens of scarcity. Since human and property resources are scarce (limited), it follows that the goods and services we produce must also be scarce. Scarcity limits our options and necessitates that we make choices. Because we “can’t have it all,” we must decide what we will have.

At the core of economics is the idea that “there is no free lunch.” You may get treated to lunch, making it “free” to you, but there is a cost to someone—ultimately to society. Scarce inputs of land, equipment, farm labor, the labor of cooks and waiters, and managerial talent are required. Because these resources could be used in alternative production activities, they and the other goods and services they could have produced are sacrificed in making the “free” lunch available. Economists call these sacrifices opportunity costs.

### Rational Behavior

Economics is grounded on the assumption of “rational self-interest.” That is, individuals make rational decisions to achieve the greatest satisfaction or the maximum fulfillment of their goals. For instance, they spend their incomes to get the greatest benefit from the goods and services they can afford.

Rational behavior means that different people will make different choices because their preferences, circumstances, and available information differ. You may have decided that it is in your best interest to attend college before entering the full-time labor force, while a high school classmate has chosen to forgo additional schooling and go to work. Why the different choices? Your academic abilities, along with your family’s income, may be greater than your classmate’s. You may also know that college-educated workers have better job opportunities and lower unemployment rates than less educated workers. Hence, you opted for college, while your former classmate—the one with less academic ability, less money, and less information—chose a job. Both choices reflect the pursuit of self-interest and are rational, but they are based on differing circumstances and information.

Of course, rational decisions may change as circumstances change. Suppose the Federal government decides it is in the national interest to increase the supply of college-educated workers. It might offer 2 years of “free” community college to all low-income students. Under these new conditions, your high school classmate might now opt for college rather than a job.

It is important to remember that rational self-interest is not the same as selfishness. People make personal sacrifices to help family members or friends, and they contribute to charities because they derive pleasure from doing so. Parents help pay for their children’s education for the same reason. These self-interested, but unselfish, acts help maximize the givers’ satisfaction as much as any personal purchase of goods or services.

### Marginalism: Benefits and Costs

The economic perspective focuses largely on **marginal analysis**—comparisons of marginal benefits and marginal costs. (Used this way, “marginal” means “extra,” “additional,” or “a change in.”) Most choices or decisions involve changes in the status quo. Should you go to school for another year or not? Should you spend more or less money on compact discs each month? Similarly, businesses regularly must decide whether to employ more or fewer workers or to produce more or less output.

Each option involves marginal benefits and, because of scarcity, marginal costs. In making choices rationally, the decision maker must compare these two amounts. Example: Your time is scarce. What will you do with 2 “free” hours on a Saturday afternoon? You could watch Gigantic State University’s Fighting Aardvarks play basketball on television. The *marginal benefit* to you would be the pleasure of seeing the game. The *marginal cost* would be the benefit from the other things you have to sacrifice to watch the game, including perhaps studying, jogging, or taking a nap. If the marginal benefit exceeds the marginal cost, then it is rational to watch the game. But if you determine that the marginal cost of watching the game is greater than the marginal benefit, then you should select one of the other options.

On the national level, government regularly makes decisions involving marginal benefits and marginal costs. More spending on health care may mean less spending on libraries, aid to the poor, or military security. In a world of scarcity, the decision to obtain