ECONOMICS IS EVERYWHERE

DANIEL S. HAMERMESH

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Preface

For over thirty years I have been bringing unusual stories into my micro principles classes and commenting on them from an economic viewpoint. At the start of the fall semester of 2001 I began doing this in the usual way. One student pointed out that it would help her if I would post these stories and my comments on them on my website; that way she could look at them later and use them to help her study for exams. I began posting these comments on a regular basis, creating an entry in what I called the "Economic Thought of the Day." A few of my friends and colleagues saw these postings and pointed out that with some expansion they would make a nice supplement to a micro principles course. This is the result.

The vignettes are organized in the same order as the topics that make up my introductory microeconomics course. This arrangement corresponds quite closely to the plans of most micro principles texts. A few texts, however, include international trade (particularly comparative advantage) as the second topic in the course, immediately after supply and demand. For teachers using such books Chapter 21 can be assigned right after Chapter 1 or, better still, after Chapter 7.

I thank James Barbour, Valerie Bencivenga, Anne Golla, Stephen Lich-Tyler, Paul Shensa, and Max Stinchcombe for their extremely helpful suggestions and comments on the manuscript, and Lawrence Hamermesh and John Siegfried for their encouragement. A number of colleagues, students, and family members made suggestions that led to the vignettes included here, and others' behavior inspired some vignettes. This volume is dedicated to Frances W. Hamermesh, who commented on the entire

manuscript, inspired many of the examples, and has encouraged and supported this project and everything else in my professional and personal lives for thirty-seven years.

Daniel S. Hamermesh
Austin
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About the Author

Daniel S. Hamermesh is the Edward Everett Hale Centennial Professor of Economics at the University of Texas at Austin. He received his B.A. from the University of Chicago (1965) and his Ph.D. from Yale University (1969). He taught from 1969–73 at Princeton, from 1973–93 at Michigan State, and has held visiting professorships at universities in the United States, Europe, Australia, and Asia. He is a Fellow of the Econometric Society, a Research Associate of the National Bureau of Economic Research, Program Director at the Forschungsinstitut zur Zukunft der Arbeit (IZA), and past president of the Society of Labor Economists and of the Midwest Economics Association. He authored *Labor Demand* and *The Economics of Work and Pay*, and a wide array of articles in labor economics in the leading general and specialized economics journals. His research concentrates on labor demand, time use, and unusual applications of labor economics (to suicide, sleep, and beauty). He has taught introductory microeconomics since 1968 to over 10,000 students.

Thinking about Economics Everywhere

In every introductory microeconomics course you are taught a large number of technical, jargon-type words. These words represent a form of shorthand, a way to summarize ideas about behavior. There is one word that I teach the very first day of my introductory class, and I believe it is the most important of all: *empathy*—the intellectual identification with the feelings, thoughts, or attitudes of someone else. A student should put himself or herself into the particular problem being discussed and ask, "How would I behave if I were confronted with those choices?" Microeconomics is very logical, and most of us think very logically in our daily lives. When confronted with economic questions, though, we too often forget our logic and get scared because somehow the questions seem different. They're not: The economic issues pose the same questions that are posed to us in many of our daily activities and that we almost always answer sensibly and correctly.

The purpose of this book is to illustrate the wide range of daily activities to which an economic way of thinking can be applied. Some of the 400 vignettes are dated to indicate that they were inspired by something that came up on that particular day, but most arose from more general musing. They are organized according to the topical arrangement of a typical introductory microeconomics course. That way they can tie into what you are learning from any standard introductory textbook. They can focus your ability to apply the formal analysis taught in class to the myriad examples that come out of our daily activities. After studying this book you should be able to see your own activities and the things that you read in newspapers, magazines, and

books or hear on television in a new, economic way. As a result you should be able to understand your world better.

Ideally you should read and think about the material in this book in small bits at a time—not all at once and not even each chapter at once. Reading and thinking about a few vignettes a day is the best way to learn from this material how to think in economic terms about everyday phenomena. A vignette in Chapter 9 gives good economic reasons why you may not want to do this, but it is the best way to learn from this volume. After reading a vignette you should go directly to the attached question and try answering it while the thought expressed in the vignette is fresh in your mind.

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PART I

Trade-Offs, Supply, and Demand

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CHAPTER 1

Trade-Offs and Opportunity Cost

1.1

Mick Jagger sang, "You can't always get what you want." This is the essence of economics: Wants are unlimited, but the resources to satisfy them are *scarce*. That's true for us as individuals, and it's also true for societies. In the same song he also states, "And if you try sometime you find you get what you need." This statement makes no economic sense. *Needs* is not an economic term. I "need" tickets to the ballet once a week, my private jet with pilot, my home theater, and a chauffeur for the limousine I would like to own. Nobody has the right to argue with my statement about what I "need." Unfortunately, I do not have the income to obtain all these things; and even if I did, the scarcity imposed by the twenty-four-hour day would prevent me from enjoying them in the style I would like. I can satisfy my basic wants; I can afford the time and income for the things that are most important to me. But we all define our needs so broadly that Mick is wrong—you can never get what you need!

> *Q: Make a list of ten things that you "need." Do you get them all? If not, is it because your income isn't high enough or because you haven't got enough time?*

1.2

In the movie *The Hand That Rocks the Cradle*, a female character makes the comment, "Today's woman has to do three things: bring

home at least $50,000 per year, [. . .], and cook homemade lasagna." It is unlikely that many women will be able to do all three, because the first and third are probably **substitutes**. A woman who is earning that much money is unlikely to have the time to cook homemade lasagna because there is a **scarcity** of time, her most important resource. The opposite side of the coin is that a woman who has chosen to spend time rolling homemade pasta is unlikely to have enough time to earn this much. ([. . .] probably can be done by both high-earning women and those who have chosen to stay at home.) But fixed resources—twenty-four hours in the day—make it unlikely that most women will be able to do all three things.

> *Q: Are the **opportunity costs** of earning and cooking constant over the day and the week, or can women (and men too) find times when one is relatively cheap and the other is relatively costly? What are these times?*

1.3

One of my female colleagues commented on the previous entry, stating, "I earn more than $50,000, and I also make homemade lasagna." My response was that **production possibility frontiers** differ, depending on a person's or country's resources and technology. She is very efficient at many things and can both earn a lot and make great home-cooked lasagna. Nonetheless, even she faces a **trade-off**, assuming that she is working and enjoying leisure efficiently. If she works more, she can earn more, but she will have less time for home cooking. If she cooks more, she won't be able to earn so much.

> *Q: Draw her **production possibility frontier** in these two activities. Now draw a point that accounts for the fact that she spends one hour a day doing absolutely nothing.*

1.4

September 13, 2001—My wife and I donate over $100 for relief for the September 11, 2001, New York terrorist attack. But our five-year-old grandson has offered to give $1 of his savings to help out. We have a much higher income than our grandson; in

fact, he doesn't earn a penny, relying only on a tiny allowance from his parents. Who is sacrificing more—whose **opportunity cost** of the contribution is greater—our grandson's or ours?

> *Q: Does the fact that our grandson and we are responding to the need for contributions after September 11 make our **opportunity cost** any different from what it would be if the charitable request were, for example, for the local United Way?*

1.5

October 1, 2001—Forcing us to spend more resources on security (using the National Guard at airports, more checkpoints entering the United States, etc.) is in the end the biggest triumph by terrorists. The government pays National Guard troops, and since the guardspeople are not at their regular jobs, output outside the security sector is diminished. The output of the security people doesn't give us anything that we would want if there were no perceived need for security. The resources used for this purpose are like a negative change in technology; they shift the **production possibility frontier** inward. In this case, unlike in the example of Mick Jagger's singing, our behavior implies that our desire for security is a basic need—it comes before anything else.

> *Q: Is this vignette correct? After all, the security guards get paid and buy things, so aren't they adding to output?*

1.6

A great example of **trade-offs** comes from the life of a full-time student. Such students can be imagined as having only two uses of their time—studying and socializing—and two outputs from those uses—knowledge acquired and social satisfaction. If a student is efficient, he or she cannot increase the amount of knowledge acquired in college without giving up social satisfaction. The **opportunity cost** of one more unit of social satisfaction is some amount of forgone knowledge, and the opportunity cost of another unit of knowledge is forgone social satisfaction. This **production possibility frontier** can shift out along each axis. A speed-reading course moves the curve out along the axis for knowledge acquisition, allowing the student to obtain *both* more

knowledge and more social satisfaction (because some time that can be saved from studying can be shifted to socializing). It's harder to think of improvements that move the curve out along the social satisfaction axis. One regrettably out-of-date example is the "Orgasmatron" in Woody Allen's movie *Sleeper*.

> *Q: Draw the production possibility frontier implied in this vignette. List one other example of a technical improvement that shifts the frontier out the learning axis, one other that shifts it out the social satisfaction axis, and one that simultaneously shifts it out both axes.*

1.7

While stranded on an airplane at the Dallas–Fort Worth airport, I was able to call the reservation number from my cell phone and rebook myself onto a later plane (since I was going to miss my connection). Without the cell phone I would have had to line up at the pay phone after getting off the plane. Technological improvements save us time or allow things to be produced more cheaply, but they also enable us to do things that make us better off that we would never have thought of doing.

> *Q: You have drawn* ***production possibility frontiers*** *in class. How would you draw what happens to the production possibility frontier in the case outlined in this vignette?*

1.8

The main function of the College of Liberal Arts Promotion and Tenure Committee is to discuss granting lifetime tenure to faculty members at the end of their probationary periods (typically six years). The dean of the college, a professor of Sanskrit, asked the following question: "Could we do better hiring a person from outside the university in place of the person we are considering for promotion? After all, we are granting someone a salary of at least $60,000 a year for the remainder of his or her career." The **opportunity cost** of granting a lifetime job to a professor is the benefits that could be obtained from an alternative use of the salary the professor would be paid over his or her lifetime.

Q: Let's say the typical professor earns $60,000 per year. What is the opportunity cost of granting lifetime tenure to a thirty-five-year-old professor who will work until age seventy?

1.9

A constant complaint by longer-term residents (more than one year) in rapidly growing Austin, Texas, is that the city is "too crowded." People complain about the traffic, crowded parks and swimming holes, and so on. They never complain about the growth in the number and variety of restaurants, theaters, and cultural events or about the increase in specialized retail outlets in town. The two are related: Bigger cities bring broader and more diverse culture and activities. The **trade-off** is that they also bring more crowds and traffic congestion. New people, those who made the choice to accept the crowds in exchange for more excitement, are clearly better off. Longer-term residents may indeed be worse off because they chose to come to the area when the trade-off was different. Some of them may have benefited from the trade-off: They may like the greater breadth of activities more than they dislike the added congestion. Other longer-term residents, though, may be worse off: The change in the trade-off goes against the preferences that initially drew them to Austin.

*Q: Graph the **production possibility frontier** implied by this discussion, labeling the axes carefully. [*Hint: *One "good" might be speed and ease of access to stores, theaters, malls, and so on.] How would that frontier shift if a new invention allowed everyone to move around town twice as fast?*

1.10

Most of the techno-toys we buy—computers, PDAs, and the like—make us better off (otherwise we wouldn't buy them). Most also involve a **trade-off** between cost and convenience: They save time and improve our lives, but they cost more to buy than the items they replaced. Very few such toys both make us better off *and* reduce our total dollar expenditure. This was true even for such techno-toys of the 1940s and 1950s as automatic washers and dryers and TVs. One is my cell phone. Because

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