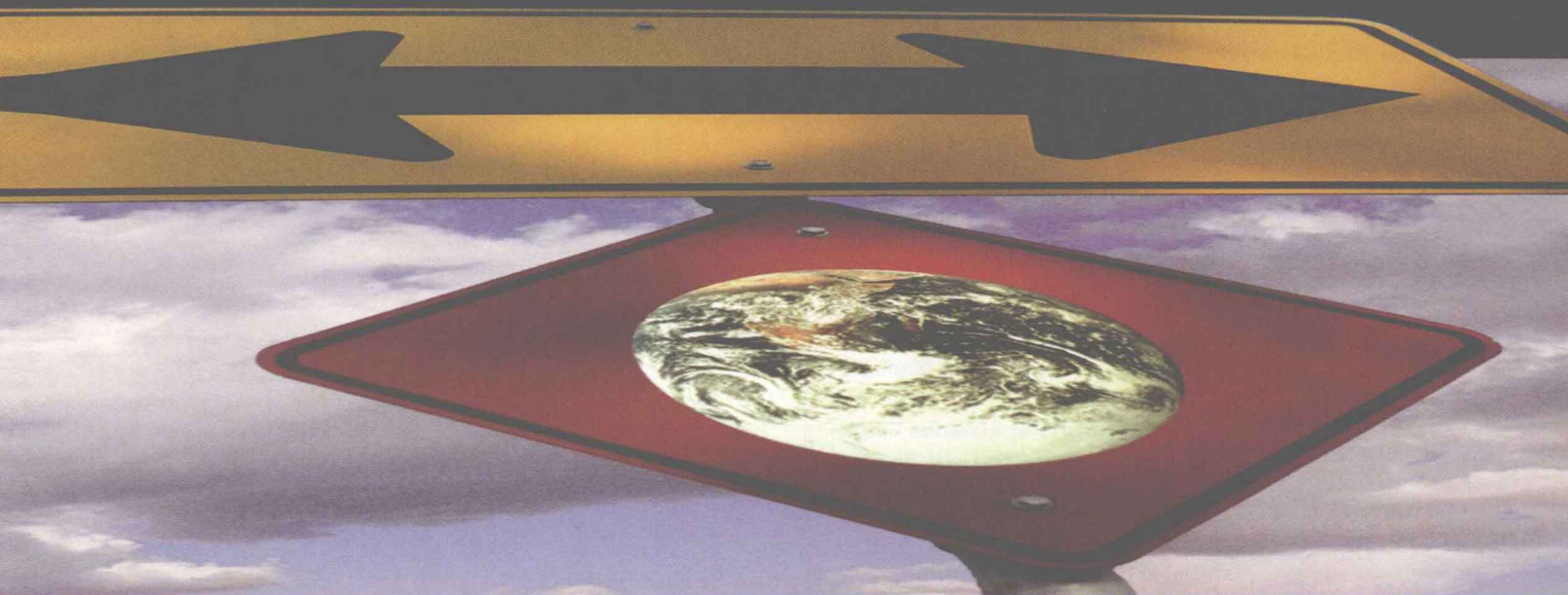


Exploring Economics

PATHWAYS TO PROBLEM SOLVING

Robert L. Sexton



Exploring Economics

PATHWAYS TO PROBLEM SOLVING



Robert L. Sexton

PEPPERDINE UNIVERSITY

THE DRYDEN PRESS

HARCOURT BRACE COLLEGE PUBLISHERS

FORT WORTH PHILADELPHIA SAN DIEGO NEW YORK
AUSTIN ORLANDO SAN ANTONIO
TORONTO MONTREAL LONDON SYDNEY TOKYO

Publisher
George Provol
Acquisitions Editor
Gary Nelson
Product Manager
Debbie K. Anderson
Developmental Editor
Amy Porubsky
Project Editor
Rebecca Dodson
Art Director
Linda Beaupré
Production Manager
Lois West
Photo/Permissions Editor
Linda Blundell

ISBN: 0-03-018329-4

Library of Congress Catalog Card Number: 98-73566

Copyright © 1999 by The Dryden Press

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopy, recording or any information storage and retrieval system, without permission in writing from the publisher.

Requests for permission to make copies of any part of the work should be mailed to:
Permissions Department, Harcourt Brace & Company, 6277 Sea Harbor Drive, Orlando, FL
32887-6777.

Address for editorial correspondence:
The Dryden Press
301 Commerce Street, Suite 3700
Fort Worth, TX 76102

Address for domestic orders:
The Dryden Press
6277 Sea Harbor Drive
Orlando, FL 32887-6777
1-800-782-4479

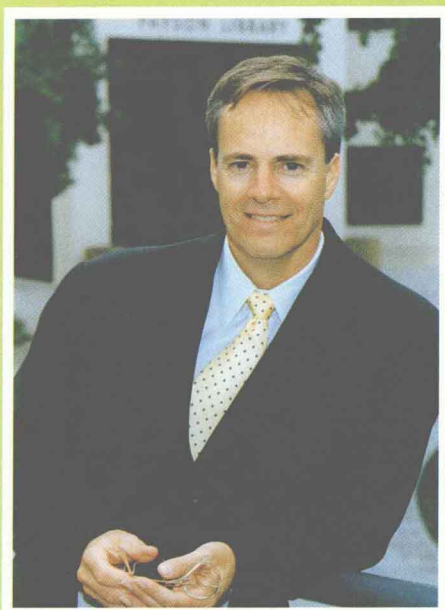
Address for international orders:
International Customer Service
The Dryden Press
6277 Sea Harbor Drive
Orlando, FL 32887-6777

Web site address: <http://www.hbcollege.com>

THE DRYDEN PRESS, DRYDEN, and the DP Logo are registered trademarks of Harcourt Brace & Company.

Printed in the United States of America
7 8 9 0 1 2 3 4 5 6 048 9 8 7 6 5 4 3 2 1

The Dryden Press
Harcourt Brace College Publishers



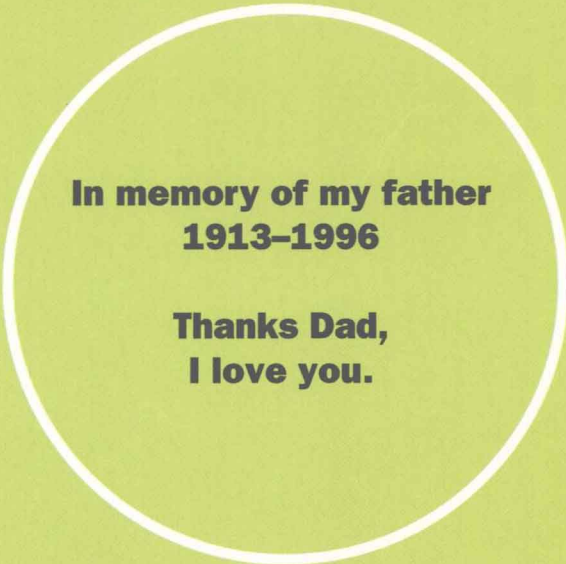
About the Author

Robert L. Sexton is currently Professor of Economics at Seaver College, Pepperdine University, and the Pepperdine School of Public Policy. Professor Sexton has also been a Visiting Professor at the University of California at Los Angeles in the Anderson Graduate School of Management and the Department of Economics.

Professor Sexton's research ranges across many fields of economics: labor economics, environmental economics, law and economics, economic education, and economic history. He has written several books and has published more than 35 research papers, many in top economic journals such as *The American Economic Review*, *Southern Economic Journal*, *Economics Letters*, *Journal of Urban Economics*, and *The Journal of Economic Education*. Professor Sexton has also written more than 100 other articles that have appeared in books, magazines, and newspapers.

Professor Sexton received the Pepperdine Professor of the Year Award in 1991 and 1997, and the Howard A. White Memorial Teaching Award in 1994; he was named a Harriet and Charles Luckman Teaching Fellow in 1994.

Professor Sexton resides in Agoura Hills, California, with his wife, Julie, and their three children, Elizabeth, Katherine, and Tommy.



**In memory of my father
1913-1996**

**Thanks Dad,
I love you.**

THE DRYDEN PRESS SERIES IN ECONOMICS

Baldani, Bradfield, and Turner
Mathematical Economics

Baumol and Blinder
Economics: Principles and Policy
Seventh Edition
(also available in Micro and Macro paperbacks)

Baumol, Panzar, and Willig
Contestable Markets and the Theory of Industry Structure
Revised Edition

Breit and Elzinga
The Antitrust Casebook: Milestones in Economic Regulation
Third Edition

Brue
The Evolution of Economic Thought
Fifth Edition

Edgmand, Moomaw, and Olson
Economics and Contemporary Issues
Fourth Edition

Gardner
Comparative Economic Systems
Second Edition

Gwartney and Stroup
Economics: Private and Public Choice
Eighth Edition
(also available in Micro and Macro paperbacks)

Gwartney and Stroup
Introduction to Economics: The Wealth and Poverty of Nations

Heilbroner and Singer
The Economic Transformation of America: 1600 to the Present
Third Edition

Hess and Ross
Economic Development: Theories, Evidence, and Policies

Hirschey and Pappas
Fundamentals of Managerial Economics: Theories, Evidence, and Policies
Sixth Edition

Hirschey and Pappas
Managerial Economics
Eighth Edition

Hyman
Public Finance: A Contemporary Application of Theory to Policy
Fifth Edition

Kahn
The Economic Approach to Environmental and Natural Resources
Second Edition

Kaserman and Mayo
Government and Business: The Economics of Antitrust and Regulation

Kaufman
The Economics of Labor Markets
Fourth Edition

Kennett and Lieberman
The Road to Capitalism: The Economic Transformation of Eastern Europe and the Former Soviet Union

Kreinin
International Economics: A Policy Approach
Eighth Edition

Lott and Ray
Applied Econometrics with Data Sets

Mankiw
Principles of Economics
(also available in Micro and Macro paperbacks)

Marlow
Public Finance: Theory and Practice

Nicholson
Intermediate Microeconomics and Its Application
Seventh Edition

Nicholson
Microeconomic Theory: Basic Principles and Extensions
Seventh Edition

Puth
American Economic History
Third Edition

Ragan and Thomas
Principles of Economics
Second Edition
(also available in Micro and Macro paperbacks)

Ramanathan
Introductory Econometrics with Applications
Fourth Edition

Rukstad
Corporate Decision Making in the World Economy: Company Case Studies

Rukstad
Macroeconomic Decision Making in the World Economy: Text and Cases
Third Edition

Samuelson and Marks
Managerial Economics
Second Edition

Scarth
Macroeconomics: An Introduction to Advanced Methods
Third Edition

Stockman
Introduction to Economics
(also available in Micro and Macro paperbacks)

Walton and Rockoff
History of the American Economy
Eighth Edition

Welch and Welch
Economics: Theory and Practice
Sixth Edition

Yarbrough and Yarbrough
The World Economy: Trade and Finance
Fourth Edition



Preface

A MODULAR APPROACH TO PROBLEM SOLVING (MAPS)

As you can see from a cursory flip, this book is different. I designed it to be different. This book differs from traditional economics texts in two important ways: (1) its modular presentation, and (2) its *focus* on economics as a problem-solving science.

The two goals of *Exploring Economics* are encapsulated in one mnemonic, MAPS: a **M**odular **A**pproach to **P**roblem **S**olving. As you will see, these ideas are not mere constructs; rather, they are complements that work together to create a unique learning experience for your students.

THE MODULAR APPROACH: WHAT AND WHY?

Exploring Economics uses a modular approach in its presentation of economic ideas and concepts. Information is presented in small, self-contained sections rather than in large blocks of text. My enthusiasm for and dedication to this approach stems from a study of learning theory research, which indicates that students retain information much better when it is broken down into short, “digestible” sections. Students *will* be more successful in mastering and retaining economic principles through this approach.

Unlike standard textbook construction, the modular approach is distinctly more compatible with the modern communication style with which most students are familiar and comfortable: short, intense, and exciting bursts of information. Rather than being distracted and discouraged by the seeming enormity of the task before them, students are more likely to work through a short, self-contained concept before getting up from their desks. The student is more likely to read and process the material before he or she proceeds to the next concept, a point that is particularly important in economics, where one idea is often a building block that serves as the foundation for the next.

In executing the modular approach in *Exploring Economics*, every effort has been made to take the intimidation out of economics. The idea of sticking to the basics and reinforcing student mastery, concept by concept, coupled with the careful display of pictures, charts, and graphs, has been done with the student in mind. But students aren't the only ones to benefit from this approach. The modular presentation allows instructors greater flexibility in plan-

ning their courses. More importantly, instructors benefit from having a student population that has actually read the textbook and prepared for class!

THE MODULAR APPROACH: HOW?

The philosophy of the modular approach takes form in the basic structure and organization of *Exploring Economics* and is also embodied in the accompanying Student Workbook.

The Text Organization

Exploring Economics is presented in 26 Modules, each of which is comprised of approximately 6–8 short Concepts. These Concepts are self-contained learning units, typically presented in 2–4 page, bite-size sections that include all of the relevant graphs and tables as well as numerous colorful photos for the topic at hand. Each Concept begins with a number of key questions designed to introduce the important ideas to be presented. These questions serve as landmarks for students: If they can answer these questions after reading the material, they have prepared well. This tool is reinforced by the Concept Check points and questions that appear at the end of each Concept. Key points summarize concisely the major ideas that the student should have retained, and short questions, the answers to which can be found in the back of the book, give students an opportunity to check their mastery before proceeding.

The Student Workbook

At the end of each Concept, students are encouraged to turn to the related section in the Student Workbook. The Student Workbook for use with *Exploring Economics* is an extension of the text, both in philosophy and in execution. Like the text, the workbook is designed on a Concept-by-Concept basis. After reading each Concept in the text, the student can turn to the Workbook and test his or her mastery of the material with true-false, multiple-choice, and discussion and application questions that cover only the topics covered in that Concept. If students can answer these questions, they can be confident that they have mastered the topic. In addition to these Concept-based questions, additional exercises are provided at the end of each Module that draw on and integrate all of the material in the Module. In short, the Workbook, like the text, is

designed at every step to instill your students with confidence in their own abilities to master the tools of economics.

THE PROBLEM-SOLVING APPROACH: WHAT AND WHY?

Economics is a collection of problem-solving tools that can be applied to many social, political, and business issues. Even everyday issues can be more easily understood when one has a good handle on the “economic way of thinking.” However, in the words of a Lake Wobegon philosopher Garrison Keillor, “Just because you sleep in a garage doesn’t make you a car.” In other words, picking up the terminology of economics is not enough; students have to learn when and how to use their new tools. Economic principles aren’t just definitions to memorize; they are valuable tools that can help students analyze a whole host of issues and problems in the world around them. It is this philosophy that serves as the focus for the problem-solving approach in *Exploring Economics*, which is designed to serve two key purposes: (1) to facilitate student mastery of concepts both theoretically and in application, and (2) to communicate a sense of relevancy to students.

THE PROBLEM-SOLVING APPROACH: HOW?

The problem-solving approach is evident throughout *Exploring Economics*—in the basic organization of the text and in the supporting pedagogical elements. This approach is also embodied in the well-integrated student ancillary materials that are packaged with the text, collectively known as the Integrated Learning System.

The Text Organization

By presenting material in a Concept-by-Concept, building-block format that encourages and reinforces students at every step, the modular approach directly supports the problem-solving focus of the text. The modular approach breaks difficult concepts into digestible parts and then offers students opportunities to evaluate their level of understanding before proceeding. In this way, students are provided with an optimal format in which to master the economic tools that they will need and to develop confidence in their own abilities and understanding of these ideas.

Learning Tools

Key Questions. Each Concept begins with a list of questions that highlight the primary ideas that the student should learn from the material. These questions are intended to serve as a preview and to pique students’ interest in the material to come.

Text Heads. Many paragraphs in the text have headings that are structured as questions. The philosophy be-

hind this approach is that if students develop the habit of asking themselves such questions, they will become much more effective learners; that is, they will begin to learn to ask the right questions themselves.

Tune Up. Tune Up boxes are scattered throughout the text as a way of reinforcing and checking student comprehension of important or more difficult concepts. These elements provide students with an opportunity to test their mastery of new tools through short applications. Students can then check their work immediately against the answer given at the bottom of the box, providing them immediate feedback and encouragement in the learning process.

Applications. There are numerous applications to everyday life situations scattered throughout the text. These applications were chosen specifically with students in mind, and they are designed to help students find the connection between economics and their lives. With that, economic principles are applied to everyday problems and issues, such as classroom cheating, sexually transmitted diseases, teenage drug use, juvenile crime, on-line betting, road kill, and the cost of raising children.

In addition to the large number of in-text examples, one integrative application is presented in the last Concept of each Module as a platform for tying together some of the primary ideas presented in the Module. Also, there are two special boxed applications, “In the News” and “Global Watch,” scattered throughout each Module.

In the News. “In the News” applications focus primarily on current news stories that are relevant and thought-provoking. These articles are placed strategically throughout the text to solidify particular concepts. In an effort to emphasize the breadth and diversity of the situations to which economic principles can be applied, these articles have been chosen from sources that range from *National Geographic* to *Wired* magazine.

Global Watch. Whether we are concerned with understanding yesterday, today, or tomorrow, and whether we are looking at a small, far-away country or a large next-door neighbor, economic principles can strengthen our grasp on many global issues. “Global Watch” articles were chosen to help students understand the magnitude and character of the change occurring around the world today and to introduce them to some of the economic causes and implications of this change. To gain a greater perspective on a particular economy or the planet as a whole, it is helpful to compare important economic indicators around the world. For this reason, “Global Watch” applications will sometimes be used to present relevant comparative statistics.

Concept Checks. Each Concept in a Module ends with a Concept Check box. This element contains 4–6 short sentences emphasizing the important points in each section. It also includes 4–6 questions designed to test students’ comprehension of the basic points of the Concept

just covered. If students can answer these questions, they can feel confident about proceeding to the next topic.

Memory Devices. Mnemonic devices are used where appropriate as an extra aid to help students remember certain important ideas. For example, “PYNTE,” the old-English spelling of *pint*, is used to help students remember the major demand shifters: *P*, price of related goods; *Y*, income; *N*, number of buyers; *T*, tastes; and *E*, expectations.

Photos. The text contains hundreds of colorful pictures. They are not, however, mere decoration; rather, these photos are an integral part of the book, for both learning and motivation purposes. The photos are carefully placed where they reinforce important concepts, and they are accompanied with inquisitive captions designed to encourage students to extend their understanding of particular ideas.

Exhibits. Graphs, tables, and charts are important economic tools. These tools are used throughout *Exploring Economics* to illustrate, clarify, and reinforce economic principles. Text exhibits are designed to be as clear and simple as possible, and they are carefully coordinated with the text material.

THE INTEGRATED LEARNING SYSTEM

The Integrated Learning System is more than an extension of the problem-solving approach to student success that characterizes *Exploring Economics*; it is, in fact, an integral part of that approach. Individually, the elements of this system—the Student Workbook, EconActive CD-ROM, and Student Web Site—can help your students take the small steps toward a mastery of microeconomics. Collectively, these elements serve as a key to your students’ ultimate goal: their mastery of the economic way of thinking and the development of a confidence in their abilities to use those tools elsewhere. This, I believe, is the ultimate success, but it is a success that must come gradually, one step at a time. The Integrated Learning System helps students take those steps by reinforcing basic concepts and ensuring student mastery at every point, using the same basic student-friendly and interactive style that characterizes the text.

Student Workbook

The Student Workbook for use with *Exploring Economics* reinforces the basic problem-solving approach of the text. On a Concept-by-Concept basis, the Student Workbook guides the student through various exercises designed to test their comprehension and mastery, including true-false, multiple-choice, and application-type questions. These exercises proceed from the relatively easy to the more difficult, thus allowing students to experience success and generate feelings of confidence as they proceed. Then, at the end of each Module, students can enjoy and learn from

“The Lowells,” a cartoon strip that illustrates a key concept from the Module and then tests student understanding of that idea. The answers to all Student Workbook activities are included in the Workbook, so that students can get immediate feedback on their work.

EconActive CD-ROM

The EconActive CD-ROM is designed to allow your students to get even more interactive and involved in their own learning process. In addition to guided tutorials with new examples and graphs, the EconActive CD-ROM also includes Java-powered, interactive graphs. The power of Java allows students to manipulate a variable or variables on a graph and immediately see the effects of those changes on the graph. The hands-on interaction that these Java-powered graphs provide illustrates and reinforces economic relationships in a way that a static graph and explanation cannot. As with the Student Workbook, the interactive graphs and the other materials on the EconActive CD-ROM are designed to reinforce student mastery and success at each point.

Student Web Site

A Student Web Site has been developed to accompany *Exploring Economics*. In addition to providing students with a secondary access to many of the learning tools that appear on their EconActive CD-ROM (including the Java-powered interactive graphs), the Student Web Site gives students access to other resources they can use to test their understanding of key economic concepts. These tools include online, interactive quizzes (multiple-choice, matching, and true-false) that provide students with immediate feedback, cyberproblems with links to relevant data or Web sites, and additional applications.

SUPPLEMENTS FOR THE INSTRUCTOR

The following ancillaries are available to instructors:

- Test Bank
- Computerized Test Bank
- Instructor’s Resource Manual
- Electronic Resource Manual
- Power Point Presentation
- Instructor Web Site
- Video Lecture Starters

WALL STREET JOURNAL EDITION

One goal in teaching the principles of economics is to provide students a better understanding of the world around them. Many instructors, therefore, encourage students to read about economic issues in the newspaper as they take

the course. Those instructors may want to consider the special *Wall Street Journal Edition* of this text. The edition is the same as the standard edition but includes a ten-week subscription to *The Wall Street Journal*. Students can activate their subscriptions simply by completing and mailing

the business reply card found in the back of the book. Talk to your Dryden Press sales representative for more information, or call 1-800-237-2665.

The Wall Street Journal is a registered trademark of Dow Jones & Company, Inc.

ACKNOWLEDGMENTS

I would like to extend special thanks to the following colleagues for their valuable insight during the manuscript phase of this project. I owe a debt of gratitude to Philip Graves, University of Colorado; Gary Galles, Pepperdine University; Richard Vedder, Ohio University; Dwight Lee, University of Georgia; Robert M. Escudero, Pepperdine University; Ron Batchelder, Pepperdine University; Steve Jackstadt, University of Alaska, Anchorage; Lee Huskey, University of Alaska, Anchorage; Robert Clower, University of South Carolina and Gary M. Walton, University of California, Davis.

Without the devotion and creativity of several people at The Dryden Press, this book would not have been possible. My appreciation goes to Gary Nelson, without whom this project would never have materialized and Amy Winston, whose detail and motivation improved the book tremendously. Also thanks to George Provol, Becky Dodson, Linda Beaupré, Linda Blundell, Lois West, Rosemarie Console, Brad Balaban, Debbie K. Anderson, Amy Porubsky, Barrett Lackey, and Kimberly Powell.

In addition, my family deserves special gratitude—my wife Julie, daughters Elizabeth and Katherine, and my son Tommy. They are an inspiration to my work. Also, special thanks to my mother Willa and my brother Bill.

Thanks to all of my colleagues who reviewed the project. From very early on in the writing phase all the way up to publication, your comments were very important to me.

Jack Adams, University of Arkansas, Little Rock
James Q. Aylsworth, Lakeland Community College
G.E. Breger, University of South Carolina
Gilbert L. Christopher, Jr., Wingate University
Andrew J. Dane, Angelo State University
John W. Dorsey, University of Maryland
David Eaton, Murray State University
Mary E. Edwards, St. Cloud State University
Robert M. Escudero, Pepperdine University
Gary Galles, Pepperdine University
Phil Graves, University of Colorado
Stanley Keil, Ball State University
Ronald Kessler, British Columbia Institute of Technology
Saleem Khan, Bloomsburg University
Philip King, San Francisco State University
Thomas Maloy, Muskegon Community College
Pete Mavrokordatas, Tarrant County Junior College
Thomas Porebski, Trinton College
Tom Potiowsky, Portland State University
Sue Lynn Sasser, William Woods University

Mark Strazicich, University of Central Florida
Howard Whitney, Franklin University

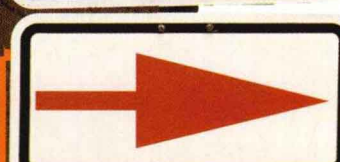
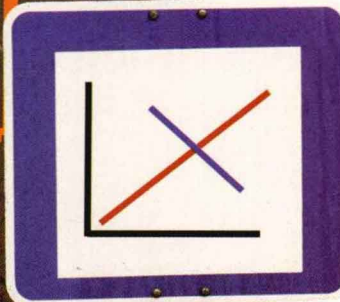
The Dryden Press conducted a national survey of professors who offered tremendous feedback on the ideas and teaching style presented with this text. A special thanks to all participants, including the following:

Steve Abid, Grand Rapids Community College
Fatma Wahdan Antar, Manchester Community College
Donald C. Balch, University of South Carolina
Randall Barnes, San Diego Miramar College
Cihan Bilginsoy, University of Utah
Barbara L. Brogan, Northern Virginia Community College
George W.M. Bullion, Indiana University–Purdue
Dennis Byrne, University of Akron
James E. Clark, Wichita State University
Joe B. Copeland, University of North Alabama
Kenneth M. Cross, Southwest Virginia Community College
John P. Dahlquist, College of Alameda
David E. Davis, University of Oregon, USDA
Richard Deitz, Rochester Institute of Technology
Mike Dunton, Delmar College
David H. Eaton, Murray State University
Dipak Ghosh, Emporia State University
Spencer R. Graf, University of Virginia
Paul F. Haas, Bowling Green State University
Peter W. Harman, Rhode Island College
Barry Haworth, University of Louisville
Wei-Chiao Huang, Western Michigan University
Paul A. Joray, Indiana University–South Bend
Patrick Joyce, Michigan Technological University
Saleem M. Khan, Bloomsburg University of Pennsylvania
Ghebre Y. Keleta, Grambling State University
Syrous Kooros, Nicholls State University
Rose M. LaMont, Modesto Junior College
Michael B. Lehmann, University of San Francisco
Stephen E. Lile, Western Kentucky University
Vernon Lynch, Fort Lewis College
Dayle Mandelson, University of Wisconsin–Stout
James M. McQuiston, University of Southern Mississippi
Green R. Miller, Morehead State University
Masoud Moghaddam, St. Cloud State University
Marie T. Mora, New Mexico State University
Amlan Mitra, Purdue University–Calumet

William R. Pedersen, Southeastern Louisiana University
Chris Phillips, Somerset Community College
Etienne E. Pracht, Louisiana State University
Rarahmand Rezvani, Montclair State University
Mark Strazicich, University of Central Florida
Thomas A. Swanke, West Virginia State College
Robert E. Tansky, St. Clair County Community College
Neil Terry, West Texas A&M University

Jesus M Valencia, Slippery Rock University
John R. Wagner, Westfield State College
Karen T. Wilson, Delta College
Willard E. Witte, Indiana University–Bloomington
Lewis Woodruff, Sinclair Community College
Douglas Woolley, Radford University
Edward G. Young, University of Wisconsin–Eau Claire

Brief Table of Contents



Module 1	Economics: Ten Powerful Ideas 2
Module 2	The Role and Method of Economics 38
Module 3	Scarcity and the Economizing Problem 64
Module 4	Supply and Demand 86
Module 5	Markets in Motion 118
Module 6	Government and the Economy 142
Module 7	Consumer Choice and Elasticities 178
Module 8	Production and Costs 210
Module 9	Perfect Competition 232
Module 10	Monopoly 254
Module 11	Monopolistic Competition 282
Module 12	Oligopoly 302
Module 13	Supply and Demand in Input Markets 318
Module 14	Income Distribution and Poverty 346
Module 15	The Environment 370
Module 16	Introduction to the Macroeconomy 388
Module 17	Economic Growth 418
Module 18	Measuring Economic Performance 438
Module 19	Aggregate Demand 464
Module 20	Aggregate Supply and Macroeconomic Equilibrium 480
Module 21	Fiscal Policy 496
Module 22	Money and the Banking System 526
Module 23	The Federal Reserve System and Monetary Policy 554
Module 24	Inflation, Unemployment, and Expectations 578
Module 25	International Trade 596
Module 26	International Finance 616
	Answers to Concept Check Questions 641
	Glossary 693
	Index 701



Contents

MODULE 1 ECONOMICS: TEN POWERFUL IDEAS 2

- (A) **Economics: A Definition 4**
What is economics?
- (B) **Wants and Desires 7**
Can all of our wants and desires be satisfied?
- (C) **Scarcity 10**
Did nature provide enough for all of our wants?
- (D) **Choices 12**
Can we have our cake and eat it too?
- (E) **Marginal Thinking 15**
What is the rule of rational choice?
- (F) **Incentives Matter 17**
Do people respond to incentives?
- (G) **Specialization and Trade 21**
How can specialization and trade lead to greater economic growth?
- (H) **Markets and the Price System 24**
Can markets and the price system make consumers and producers better off?
- (I) **Government Policies 27**
Can appropriate government policies improve our economic well-being?
- (J) **Economic Growth 30**
Can economic growth improve overall standards of living?
- (K) **Price Stability 32**
Will price stability enable producers and consumers to make better plans and decisions?
- (L) **Application: Laws and Enforcement Costs 34**
How can strict laws function as incentives to influence behavior?

ONE STEP BEYOND 36

IN THE NEWS: CLINTON MOURNS THE LOSS OF TWO REMARKABLE WOMEN 9

TUNE UP: DO INCENTIVES MATTER? 18

IN THE NEWS: SURVEY FINDS CHEATING NOT UNCOMMON AMONG TOP U.S. HIGH SCHOOL STUDENTS 19

GLOBAL WATCH: DRUNK DRIVING DRAWS GLOBAL WRATH 20

TUNE UP: COMPARATIVE ADVANTAGE 21

IN THE NEWS: MICHAEL JORDAN SIGNS NEW CONTRACT 23

GLOBAL WATCH: CORRELATION OF INVESTMENT AND GROWTH 31



MODULE 2 THE ROLE AND METHOD OF ECONOMICS 38

(A) Economics as a Science 40

Why is economics useful?

(B) Economic Behavior 43

Can economists predict human behavior?

(C) Economic Theory 45

Why do we need a theory?

(D) Problems with Scientific Thinking 48

What are the key problems in scientific thinking?

(E) Positive and Normative Analysis 52

Why is it important that we distinguish between positive and normative analysis?

(F) Application: Scientists and Global Warming 56

Why must we be so careful about association and correlation?

ONE STEP BEYOND 57

APPENDIX: WORKING WITH GRAPHS 58

MODULE 3 SCARCITY AND THE ECONOMIZING PROBLEM 64

IN THE NEWS: BILL GATES, THE
ENTREPRENEUR 68

(A) The Factors of Production 66

What are the factors of production?

TUNE UP: THE PRODUCTION POSSIBILITIES
CURVE 71

(B) The Production Possibilities Curve 69

Why is the production possibilities curve useful?

GLOBAL WATCH: GOVERNMENT SPENDING AS
A PERCENTAGE OF GDP, 1920 AND 1996 74

(C) Production Decisions 73

What and how much should we produce?

TUNE UP: DID THE MARKET FAIL? 75

(D) Production Methods 76

How will we produce those goods and services?

IN THE NEWS: LABOR-SAVING ANTI-THEFT
DEVICES 77

(E) Distribution of Output 78

Who will get the goods and services we produce?

(F) Efficiency in Production 79

How can we use our scarce resources efficiently?

GLOBAL WATCH: FIVE RICHEST AND FIVE
POOREST NATIONS IN OUTPUT PER
PERSON 81

(G) Production and Growth 81

What do we have to sacrifice today to achieve greater economic growth?

TUNE UP: PRODUCTION POSSIBILITIES
CURVE 83

(H) Application: Tourism versus Ecosystems 84

Can we have more tourism and a better environment at the same time?

ONE STEP BEYOND 85

MODULE 4 SUPPLY AND DEMAND 86

(A) Markets 88

What is a market?

(B) Money and Relative Prices 90

Why are relative prices so important?

(C) The Law of Demand 92

What is the difference between needs and wants?

(D) The Demand Curve 96

Why is the demand curve negatively sloped?

(E) Shifts in the Demand Curve 99

What are the major variables that determine the position of the demand curve?

(F) The Law of Supply 108

Why is the supply curve positively sloped?

(G) Shifts in the Supply Curve 110

What are the major variables that determine the position of the supply curve?

(H) Application: A Shift in the Demand for Cuban Cigars 116

Which variables have impacted the demand curve for Cuban cigars?

ONE STEP BEYOND 117

MODULE 5 MARKETS IN MOTION 118

(A) Market Equilibrium Price and Quantity 120

Why is the concept of market equilibrium such a valuable tool?

(B) Changes in Equilibrium Price and Quantity 124

What happens to equilibrium price and quantity when we shift the supply or demand curve?

(C) Shifting Supply and Demand Together 128

What happens when supply and demand both shift?

(D) Temporary Disequilibrium 133

What happens when companies do not correctly anticipate the demand for their products?

(E) Price Controls 136

What are price ceilings and price floors?

(F) Application: Supply and Demand in the Market for Super Bowl Tickets 140

How does the market for Super Bowl tickets work?

ONE STEP BEYOND 141

IN THE NEWS: LUNDBERG SURVEY SAYS GASOLINE PRICES HIT HISTORIC LOW IN 1998 90

TUNE UP: TOOLING UP: RELATIVE PRICES 91

IN THE NEWS: GOODYEAR BEGINS SEARCH FOR HIGHWAY HEROES 94

IN THE NEWS: IS THERE A DEMAND CURVE FOR ROADKILL 97

IN THE NEWS: CAN A WIENER BECOME A POORER SUBSTITUTE FOR HAMBURGER 100

TUNE UP: SUBSTITUTE GOODS 101

TUNE UP: COMPLEMENTARY GOODS 102

TUNE UP: NORMAL AND INFERIOR GOODS 103

TUNE UP: EXPECTATIONS OF HIGHER PRICES 104

IN THE NEWS: WHAT IS A TAMAGOTCHI? 106

TUNE UP: CHANGES IN DEMAND VERSUS CHANGES IN QUANTITY DEMANDED 108

TUNE UP: SUPPLIERS' INPUT PRICES 111

TUNE UP: EXPECTATIONS CAN SHIFT SUPPLY 112

TUNE UP: TAXES AND REGULATION AS SUPPLY SHIFTERS 112

IN THE NEWS: SUPPLY SHIFTERS IN THE OIL INDUSTRY 113

TUNE UP: CHANGE IN SUPPLY VERSUS CHANGE IN QUANTITY SUPPLIED 115

TUNE UP: SHORTAGES 121

TUNE UP: SHORTAGES AND SURPLUSES 122

GLOBAL WATCH: COFFEE, COCOA PRICES RISE ON EL NIÑO CONCERNS 126

TUNE UP: THE IMPACT OF A CHANGE IN DEMAND ON EQUILIBRIUM PRICE AND QUANTITY 126

TUNE UP: THE IMPACT OF A CHANGE IN SUPPLY ON EQUILIBRIUM PRICE AND QUANTITY 127

TUNE UP: SHIFTS IN BOTH SUPPLY AND DEMAND 130

IN THE NEWS: KIDNEYS FOR SALE? 131



MODULE 6 GOVERNMENT AND THE ECONOMY 142

- (A) **Government and Property Rights 144**
Should government protect property rights?
- (B) **Government and Externalities 146**
Should government intervene to correct externalities?
- (C) **Government and Public Goods 150**
Should government provide public goods and services?
- (D) **Government and Information Costs 153**
Should government provide information to consumers?
- (E) **Other Government Functions 157**
How does government try to prevent insufficient competition and achieve its macroeconomic goals?
- (F) **Government and Income Distribution 159**
Should government work to create more equality in income distribution?
- (G) **Public Choice 162**
Is politics influenced by self-interest?
- (H) **Spending and Taxation 168**
How do we pay for government?
- (I) **Application: Revving Up the Helmet Law Debate 174**
Can a balance of the freedom of the rider and the freedom of the taxpayer be found?

ONE STEP BEYOND 176

MODULE 7 CONSUMER CHOICE AND ELASTICITIES 178

- (A) **Consumer Behavior 180**
What is utility?
- (B) **The Consumer's Choice 183**
How do consumers maximize their satisfaction?
- (C) **Consumer Surplus 186**
What is consumer surplus?
- (D) **Price Elasticity of Demand 190**
What is price elasticity of demand?
- (E) **Total Revenue and Price Elasticity of Demand 197**
What is the relationship between price, total revenue, and the price elasticity of demand?
- (F) **Other Types of Elasticities 200**
How are other types of elasticities useful?

IN THE NEWS: RUDOLPH THE RED-TAPED
REINDEER 155

TUNE UP: RATIONAL IGNORANCE 164

IN THE NEWS: WILD PITCH 166

IN THE NEWS: CONTROVERSIAL TRANSIT BILL
PASSES IN HOUSE 171

GLOBAL WATCH: A GLOBAL COMPARISON OF
TAXATION 172

TUNE UP: MARGINAL UTILITY 182

TUNE UP: CONSUMER SURPLUS 188

IN THE NEWS: CLINTON TARGETS
TEEN SMOKING 194

IN THE NEWS: EARTH'S BIGGEST
BOOKSTORE 195

TUNE UP: ELASTICITIES AND TOTAL
REVENUE 198

GLOBAL WATCH: DRUGS ACROSS
THE BORDER 205