# APPLYING ECONOMIC PRINCIPLES



# APPLYING ECONOMIC PRINCIPLES

Sanford D. Gordon Alan D. Stafford Alan Stafford earned a Bachelor of Science degree in economics from the honors program at Western Michigan State University and Master's degrees in social studies education and business administration from the State University of New York. He served as a Peace Corps volunteer in Micronesia, taught in an urban high school for 12 years, and currently is an associate professor of economics at Niagara County Community College. He has taught courses sponsored by the New York State Department of Education and the New York Developmental Economics Education Program (DEEP). A recipient of 2 first place teaching awards from the New York State Council on Economic Education, he is coauthor of several economics texts.

**Sanford D. Gordon** earned a Ph.D. in economics from New York University. Active in the economic education movement since 1960, he served as the Executive Director of the New York State Council on Economic Education from 1979 to 1989. He is a recipient of the Calvin Kazanjian Foundation award for innovation in teaching economics and the first winner of the Bessie B. Moore Award for outstanding service and dedication to excellence and innovations in economic education. Dr. Gordon has authored many books on economics and economic education and has been adviser to numerous school districts, the New York State Education Department, banks, and local governments.

#### **Reviewers and Consultants**

#### Christine A. Blumberg

Social Studies Teacher Burnt Hills—Ballston Lake Senior High School Burnt Hills, New York

#### Randolph J. Pachuta

Curriculum Specialist— Social Studies The School Board of Broward County Lauderdale Lakes, Florida

#### **Peter Pitard**

Department Chairperson, Learning Handicapped Grossmont High School La Mesa, California

#### Imprint 1997

Copyright © 1994 by Glencoe/McGraw-Hill. Portions of this book are taken from *Basic Economic Principles* © 1989 by Glencoe Publishing Company, a division of Macmillan, Inc. All rights reserved. Except as permitted under the United States Copyright Act, no part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without prior written permission of the publisher.

#### Harvey L. Prokop

Program Manager, Social Studies Educational Services Division, San Diego City Schools San Diego, California

#### **Delores Marie Robinson**

Curriculum Specialist, Mentor Teacher Roosevelt High School Fresno, California

#### Joseph Weintraub

Regional Administrator, New York City Developmental Education Program Adjunct Professor of Economics Nassau Community College Garden City, New York

#### James H. Wimberly

Social Studies Curriculum
Director/Secondary
Bibb County Board of
Education
Macon, Georgia

Send all inquiries to: Glencoe/McGraw-Hill 936 Eastwind Drive Westerville, Ohio 43081

ISBN 0-02-822711-5 (Student Text) ISBN 0-02-822712-3 (Teacher's Annotated Edition)

7 8 9 10 11 12 13 003/043 03 02 01 00 99 98

### Why Study Economics?

Economics has become an increasingly important high school course in recent years. This is partly because many people believe America as a nation will be better off if we all understand how our economy works. Another reason is this: If you understand how the economy works, you personally will be better off too.

All of us live in the economy, and we all must make economic choices. You will soon discover that you have been making economic choices all your life—even when you haven't thought of them as such. As you study economics, you will learn to make these decisions using logic and common sense. This does not have to be difficult, and it can be very interesting. It can also be profitable. The more you know about economics, the better equipped you will be to make choices that bring you the most satisfaction for your time and money.

#### How to Use This Book

This book will help you understand how economics and your life fit together. It is designed to do this in a way you will find easy to understand. The following features are especially important in using this book.

#### The Personal Narrative

Each chapter is divided into sections that begin with a Personal Narrative. The Personal Narratives are made-up stories that describe people who are roughly your age. The people in these stories experience problems that could be real. As you read the Personal Narratives, you will discover that principles of economics are at work in important events in the lives of these people. The same principles of economics also affect important events in your life.

Following each Personal Narrative is a section of text that explains the concepts that were demonstrated in the Personal Narrative. Together, the text and the Personal Narratives show how economics is a part of your everyday life. You'll find that the study of economics will help you understand what is happening in the world around you and will assist you in making better decisions.

## **Section-by Section Organization**

This textbook is organized in sections, to enable you to concentrate on important individual principles. The list of Objectives at the beginning of each chapter shows the main principles to look for in each section. At the end of each section, the Self-Check questions help you briefly review what you have learned. The Applying What You Have Learned questions give you an opportunity to reexamine the Personal Narrative and other real-world situations.

#### **Current Economic and Consumer Issues**

Near the end of each chapter, you will find either a Current Economic Issue or a Current Consumer Issue. Current Economic Issues deal with economic questions that face the nation. As elected officials address each issue, their decisions will affect every American. Current Consumer Issues will likely affect you directly as you participate in making consumer choices. As you study such issues, you will discover that many problems of economics involve social and political values. That is one reason why people often disagree over what should be done to solve economic problems.

### **Developing Your Economic Skills**

At the very end of each chapter, you will find a Developing Your Economic Skills feature. Each of these features gives step-by-step instructions on how to use a particular kind of skill that is important in economics. For example, one skills feature will show you how to read a table; another will show you how to interpret a bar graph. Each feature has a Skill explanation, an Application, and a Practice to give you hands-on experience in using the skill. Your teacher may ask you to study a particular skills feature when you first read the chapter or as a reference to review that particular skill.

## **Photographs and Figures**

There are many photographs, tables, and graphs in this book. Each was included to illustrate one or more economic concepts. You have heard the saying, "one picture is worth a thousand words." The same is true of these figures. They provide information that would often take many written pages to communicate.

Each photograph is accompanied by a caption that explains a concept of economics. Each figure is explained in nearby text. Take the time to read these captions and explanations. They will make your work much easier in this course and in many other situations in the future.

### **Highlighted Vocabulary Terms**

At the beginning of each section is a short statement of important terms and concepts that you will find in the section. Within the section itself, you will see that some terms are set in a heavy, dark type—these are the most important vocabulary terms. These terms are defined in the Glossary at the end of the book and are reviewed in each Chapter Review. As you read the text, if you forget exactly what a particular economic term means, look it up in the Glossary. The Glossary will define the term, and give you a page number where you can read more about it in the text.

#### **Review Activities**

Each chapter and part of the text is followed by a series of activities. All of these Activities will help you check your understanding of economic concepts. Many provide you with additional information. Some give you a chance to apply what you have learned about economics to new situations. Your teacher will probably assign some of these activities as classwork or homework. Don't be surprised if sometimes different students are assigned different activities. There is a wide selection of things to do, and your teacher has been trained to decide which are best for each student.

You may know little about economics right now. If you make a reasonable effort, that statement will not be true in a few months. You will discover that there is a logic about economics that tells you much about the way people behave and about the way things happen in the world. In learning those things, you will learn much that is valuable to you in your everyday life.

TO THE STUDENT

XXX

3

# PART 1 U

Understanding the Fundamentals of Economics



Chapter 1	Life Is Economics	5
Section A	<b>Unlimited Wants and Limited Resources</b>	8
Section	Personal Narrative: I Don't Have Enough	8
	Unlimited Wants and Limited Resources	9
	Consumers Must Choose	9
	Businesses Must Choose	9
	The Government Must Choose	9
Section B	<b>Everyone Pays Opportunity Costs</b>	11
	Personal Narrative: If I Buy You a Pizza,	
	I Can't Put Gas in My Car	11
	Opportunity Costs	11
	Businesses Pay Opportunity Costs	12
	Governments Pay Opportunity Costs	13
	Everyone Makes Trade-Offs	13

Section C	From Resources to Products Personal Narrative: I Built a Dog House From Resources to Products The Four Factors of Production	14 14 14 15
Section D	How Economists Use Models Personal Narrative: How Do You Talk to Someone You Don't Know? Using Models Models Are Based on Assumptions Models Can Be Revised Economic Predictions Affect Us All	17 17 17 18 19
Section E	Making Rational Choices Personal Narrative: My Mother Wants Me to be a Doctor Making Rational Choices Positive Statements Normative Statements Social Values and Choices Putting Rational Choices to a Test	20 20 21 21 22 22
Section F	Using the Production Possibilities Frontier Personal Narrative: Should I Grow More Cucumbers or More Tomatoes? The Production Possibilities Frontier	24 25
	Current Consumer Issues: Should High School Graduates Come With a Guarantee?	27



Chapter 1	Review	28
	Developing Your Economic Skills: Constructing a Line Graph	31

Chapter 2 Economic Systems: Who Made the Rules? 33



Section A	How Economic Systems Developed	35
	Personal Narrative: From Yesterday to Tomorrow	35
	The Division of Labor	36
	Specialization Increases Productivity	36
	Wealth Permits Investment	37
	Examples of Increased Productivity	37
Section B	The Basic Questions: What, How, and For Whom?	40
	Personal Narrative: Should We Sell Yogurt in the School Store?	40
	Answering the Basic Economic Questions	41
	What?	41
	How?	41
	For Whom?	41

PBH 37/08

Section C	<b>The Role of Profits in the Economy</b> Personal Narrative: <i>If I Make It Big, I Can Retire</i>	44
	When I'm 30 Profits Allocate Resources Profits Are an Incentive Profits Allocate Resources	44 44 44 45
Section D	Economic Decisions in Other Systems Personal Narrative: <i>A Visit Home</i> Other Ways to Decide What, How, and For Whom Capitalism Compared to Command Economies Decisions in a Command Economy	47 47 48 48 49
	Current Economic Issues: Achieving the American Dream	51



Chapter 2	Review	52
	Developing Your Economic Skills: Interpreting a Table	55
Part 1	Review Summary of Major Economic Concepts Understanding Economic Concepts Writing About Economics Discussing Economics Problem-Solving in Economics	56 56 56 57 57 58

PART 2

# Understanding How Individuals and Businesses Make Economic Decisions

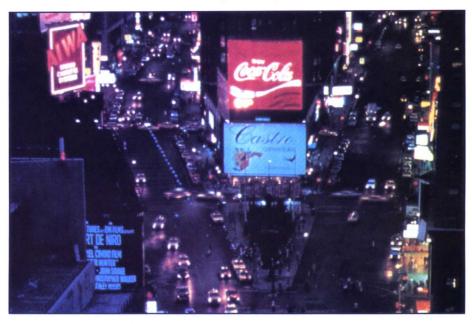
61



Chapter 3	Demand and Supply	
Section A	The Elements of an Economic System Personal Narrative: My Father Was a Farmer The Circular Flow Model	<b>64</b> 65
Profile	Adam Smith	68
Section B	The Law of Demand Personal Narrative: He Used to Say, "Everyone's Got to Eat"  Demand Demand Schedule Demand Curve Changes in Demand	69 69 70 70 71
Section C	The Law of Supply Personal Narrative: Many Other People Thought the Same Supply Supply Schedule	73 74

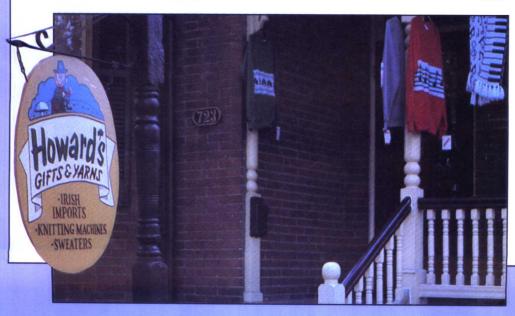
	Supply Curve Changes in Supply	75 75
Section D	Surpluses, Shortages, and Equilibrium Personal Narrative: Some Years Were Good,	77
	and Some Years Were Bad Determining Equilibrium	77 78
<b>Section E</b>	Elasticity Personal Narrative: Every Time We Grew	81
	More Food, the Price Went Down Elasticity of Demand	81 81
	Current Consumer Issues: What Value Is There In Designer Clothing?	87
Chapter 3	Paviava	
Chapter 3	Review	88
	Developing Your Economic Skills: Using a Demand and Supply Graph	91
Chapter 4	The Consumer and the Economy: Getting What You Pay For	93
Section A	How We Make Spending Decisions Personal Narrative: What Should I Do with My Pay? Diminishing Marginal Utility	<b>94</b> 94 94

Section B	Consumer Sovereignty Personal Narrative: Baggy Pants Are Out This Year Consumer Sovereignty The Invisible Hand	98 98 98 100
Section C	Individual Freedom and Consumer Protection Personal Narrative: My Uncle Smokes a Pack a Day Why Consumer Protection? What Are the Trade-Offs?	102 102 103 104
Section D	Advertising and Consumer Demand Personal Narrative: The Man on TV Said I Should Buy It Increasing Demand	106 106 107
	Current Consumer Issues: How Should We Regulate Cigarette Advertising?	109

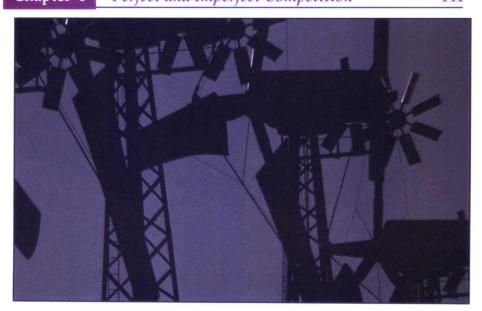


Chapter 4	Review	110
	Developing Your Economic Skills:	
	Using Line Graphs to Compare Data	112

Chapter 5	Business and the Economy		apter 5 Business and the Economy	
Section A	Forms of Business Organization Personal Narrative: I Want to Be the Boss:	116		
	How Should I Begin? Forms of Business Organization	116 117		
	Single Proprietorship	117		
	Partnership	119		
	Corporation	119		
<b>Section B</b>	The Costs of Production Personal Narrative: How Much Does It Cost	122		
	to Run a Business?  Costs Fixed Costs Variable Costs Controlling Costs	122 122 123 123 123		
<b>Section C</b>	<b>Reducing Average Fixed Costs</b> Personal Narrative: I Could Earn A Bigger Profit	125		
	if I Sold Popcorn Too Reducing Average Fixed Costs	125 125		
<b>Section D</b>	Rent, Interest, and How Businesses			
	Obtain Money	129		
	Personal Narrative: If I Borrow \$50,00 I Can Open Up Another Store	129		
	Obtaining Resources Loans	130 130		



	CONTENTS	
	Bonds Stock	132 132
	Current Economic Issues: The Fixed Cost of Medical Equipment	134
Chapter 5	Review	135
	Developing Your Economic Skills: Using Tables to Help Make Decisions	138
Chapter 6	Perfect and Imperfect Competition	141



Section A	Perfect Competition Personal Narrative: One in a Million Perfect Competition Diversification The Market as a Regulator	143 143 143 144 144
Section B	Monopolies Personal Narrative: One of a Kind Imperfect Competition	<b>147</b> 147 147
Profile	Joan Robinson	152

Section C	Combinations and Big Business Personal Narrative: A Discount Store Opened Up	153
	in Town and I May Lose My Business	153
	Small Business—Big Business The Emergence of a Monopoly	154 155
	The Emergence of a Monopoly A Horizontal Combination	156
	A Vertical Combination	156
<b>Section D</b>	Advantages and Disadvantages	
	of Big Business	158
	Personal Narrative: A Discount Store Opened Up in Town and I Can Buy For Less	158
	Economies and Diseconomies of Scale	158
	Costs and Benefits from a Monopoly	160
<b>Section E</b>	The Government's Role in Competition	162
	Personal Narrative: <i>I Can't Understand My Phone Bill</i> Workable Competition and Antitrust Policy	162 163
	Where Is Antitrust Policy Today?	166
	Current Consumer Issues:	
	Should Newspapers Be Allowed to Merge?	167
Chapter 6	Review	168
	Developing Your Economic Skills:	
	Using a Table to Compare Prices	171
	Labor and the Economy: "I Built	
Chapter 7	a Railroad,"	173
Section A	How Wages Are Set	175
	Personal Narrative: Sure I'd Like a Job, But How Much Will It Pay?	175
	The Circular Flow Revisited	176
	Diminishing Returns	177
	Demand for Workers Supply of Workers	177 178
	Equilibrium for Wages	178
Section B	Labor Unions in the Economy	182
	Personal Narrative: I Want a Living Wage	182

	What Are Labor Unions? Types of Unions Labor Legislation Union Membership	182 183 185 186
Section C	Labor-Management Relations Personal Narrative: Daddy's out on Strike Resolving Conflict Collective Bargaining The Government's Role	188 188 189 190 191
Section D	Minimum Wages and Employment Personal Narrative: I've Got Some Good News and Some Bad News The Impact of Minimum Wages	193 193 193
	Current Consumer Issues: What Should You Look For in a Job?	197



Chapter 7	Review	198
	Developing Your Economic Skills: Using Line Graphs to Compare Trends	202