

# ECONOMIC BEHAVIOR



**Jerry K. Rohacek**

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# Preface

This is a short, friendly book about the principles of economics. It is not encyclopedic; rather, it presents economics as an evolving system of knowledge and contains a good balance between theories and applications. It also avoids mathematics and sophisticated economic apparatuses.

I wrote the book for both the one- and the two-term principles of economics courses, although my primary focus was on the one-term course. If you use the text in that course, but want to cover less ground, I recommend that you either skip the Application Questions at the end of each chapter or bypass some of the chapters. You can avoid Chapters 5, 6, 9–13 and 18 without a loss of continuity.

If you are using the text in a two-term sequence, then you have enough time to cover it all, and in-depth. For the micro-macro sequence, you can deal with the chapters in order. For the macro-micro sequence, the one employed at my school, I suggest you cover Chapters 1–4 and 14–19 in the macro class and then Chapters 5–14 and 20 in the micro class.

To present a gradually evolving system of knowledge, I organized the book around phenomena rather than economic concepts, and I followed the rule that simplicity should be sacrificed only when there is a sufficient gain in generality. Accordingly, the text presents an economic individual, perhaps a Robinson Crusoe, and then introduces the individual to increasingly more complex circumstances, those necessary to explain and predict additional sets of phenomena. As the complications are introduced, an economy is eventually built from scratch, an economy that approximates the one in which we live.

To obtain a good balance between theories and applications, I devoted about as much space to theories as I did to applications. As noted above, the division between theories and applications is close to 40:60.

I covered theories explicitly and in a very organized fashion. Theory presentations begin with an identification of some phenomena. The phenomena are then explained with concrete examples. Next, the explanations are used to generate various predictions. And finally, the theories are summarized.

After presenting the theories, I covered the applications as special topics. The applications are both various and brief. Variety gives perspective, while brevity provides simplicity and maintains interest. I chose the applications for their abilities to illustrate theories and for their entertainment value. The applications range from the standard variety to the unusual, as the following ten samples illustrate:

Can the Old Compete With the New?  
 The German Hyperinflation of the 1920s  
 Industrialization and the Jeffersonian Embargo  
 Head Hunters versus Want Ads  
 Can Farmers Avoid Cyclical Unemployment?  
 Adopting Children  
 Parker Brothers' Monopoly  
 Memory Money  
 Chicken Little and Production  
 Penny's Cooking

The applications are crucial. They help focus attention on the fundamental goal of the text and of economics: the explanation and prediction of economic phenomena—not the explanation of economic theories. The text is primarily concerned with recessions, not the Keynesian Cross. It focuses on consumer reactions to prices, not indifference curves. Theories shouldn't be and aren't ignored—almost all the standard ones are carefully and explicitly covered in the theory sections of the chapters. Theories are simply not ends in themselves. They are tools for the explanation and prediction of the phenomena contained in the applications and, more importantly, in the real world. The content of the material is fairly standard. Almost all the ideas are in one way or another contained in texts such as Samuelson and Nordhaus's *Economics* or Alchian and Allen's *University Economics*.

I owe a great deal to the many people who encouraged, tolerated, or directly aided the writing of this book. My debt to them is tremendous. Most of them helped me out of friendship or scholarship, and even the ones that were paid did far more than was necessary.

But my greatest debts are to my family: my mother, father, and stepfather, Rudolf Mikuta; my son, Don, my daughter, Lisa, and my wife, Penny. Penny deserves special thanks for reading and typing various versions of the manuscript as well as sitting in solitude, patiently and without complaint, while I wrote.

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# 1

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## Introduction

What caused the Great Depression? How do some investors make millions on the New York Stock Exchange? Will a large increase in the U.S. national debt lead to an economic catastrophe? These are just some of the questions we will answer in this book on economics.

We will also deal with queries that you might expect to lie beyond our realm: Why do some people advertise for dates in the newspaper? Why does the World Series tend to go seven games? What roles do manners and customs play in American society? These questions will be within our focus because economics is much more than “the science of business.” It is a study concerned with all economic behavior, behavior that occurs at play as well as at work, in our economy’s public sector as well as in its private sector.

There are many reasons why you may want to learn about economic behavior. The most basic ones are that you will then know more about your environment, better understand what you read, and more intelligently discuss important social issues. After all, many of the things we see each day are economic in nature. And you can’t read *Newsweek* or *Time* magazines without encountering discussions that involve economics in some way. Moreover, as a business or political person, almost all your conversations will center on economic issues, their meaning and their implications.

An understanding of economics can also improve your political decisions. Once you know what is likely to occur under various economic circumstances, you will be better able to decide which circumstances you want to exist.



Yet another reason for studying economics is that it can help you make better personal and business choices. With a knowledge of economics, you may be able to predict the consequences of various actions, effects that you might have otherwise overlooked.

However, you shouldn't expect that a knowledge of economics will radically change your behavior. For example, just because you may understand the economic effects of buying Japanese cars doesn't mean that you will be more or less likely to buy one. Rather than telling you how you should behave, economics tries to explain and predict how you do behave.

Before we begin to deal with economic behavior, in this first chapter we further discuss science and economics and also say something about theory, scope, and organization. You will then better know the nature of economics and be able to respond to some of the most common criticisms of the study. For instance, you will understand why economics is a science even though economists seldom conduct controlled experiments. You will also know why economic theories are useful even though they may yield imperfect results.

Our brief coverage of the nature and method of science, and specifically of economics, represents but one of many reasonable and useful approaches to the subjects. You can examine some of the other approaches by reading one of the many books on the philosophy of science.

## SCIENCE AND ECONOMICS

### Verifiable Predictions of Phenomena

Let's begin with science. **Science** is primarily an attempt to provide verifiable predictions of phenomena.

Specifically, a study has to pass two tests to be scientific. First, it has to focus on phenomena. The term **phenomenon** means any observable thing or event, unusual or not. Although scientists try to forecast the eruptions of volcanoes and the melting of polar ice, they also attempt to predict the most trivial of our daily individual and social activities.

Second, a study must present its predictions in a way that is directly or indirectly **verifiable**, in a manner that allows for the accumulation of observable evidence that can help support or refute the predictions. For instance, we can directly verify the prediction that lower prices will increase sales, since we can measure both prices and sales. However, we can't directly verify the prediction that more money will improve personal happiness. Although we can see if someone has more money, we can't see if the person is happier, since happiness is a nonobservable state of mind.

If a study passes the two tests, it is scientific even if it makes some wrong predictions. Science requires only an attempt at providing verifiable predictions of phenomena. All sciences—physics and chemistry as well as sociology and political science—predict phenomena with varying degrees of imperfection.