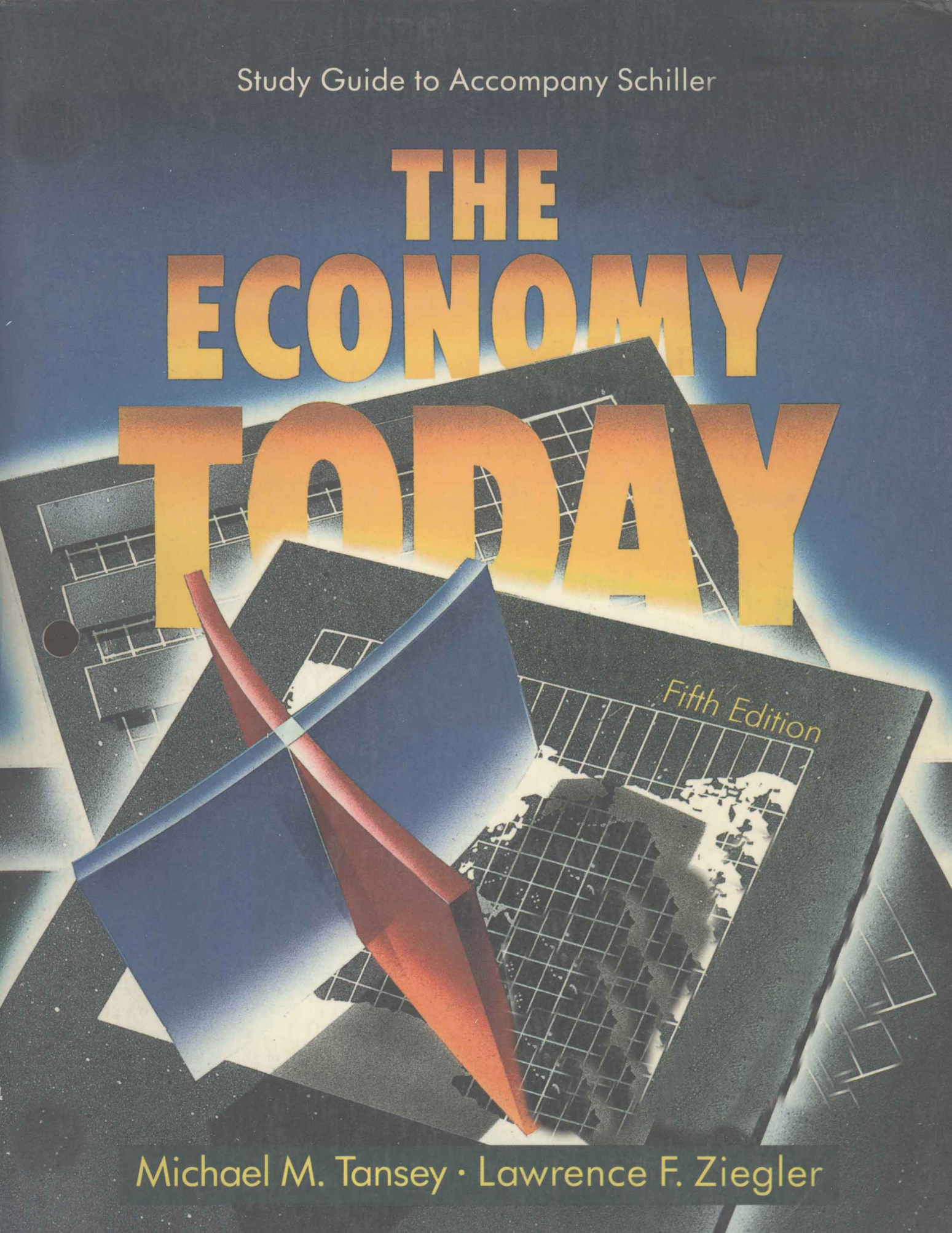


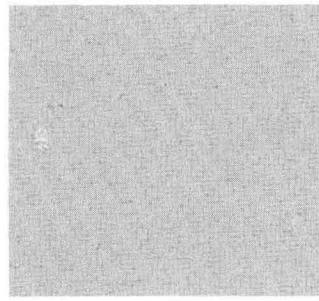
Study Guide to Accompany Schiller

THE ECONOMY TODAY

The background of the cover features a complex, abstract geometric design. It consists of several overlapping, tilted planes in shades of blue and red. A grid pattern is visible on some of these planes, particularly on the one that also contains a map of the United States. The overall effect is a sense of depth and dynamic movement.

Fifth Edition

Michael M. Tansey • Lawrence F. Ziegler



STUDY GUIDE
to Accompany Schiller:

THE ECONOMY TODAY

Fifth Edition

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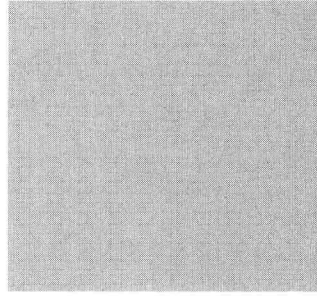
Study Guide to Accompany Schiller: **The Economy Today**

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Study Guide to Accompany Schiller:

THE ECONOMY TODAY



To the Instructor

This *Study Guide* is an important part of the complete and fully integrated textbook package called *The Economy Today*. Students who use this *Study Guide* on a continuous basis should be able to remember what they have read in their textbook and heard in your lecture. It should enable them to apply to examinations the principles they learn and, more important, should help them recognize the same principles at work in their daily experiences. Each section of each chapter has a particular objective, which is described in the following paragraphs.

The *Quick Review* and *Learning Objectives* sections provide brief summaries of the basic contents of the corresponding text chapters and outline the important areas of the *Study Guide*. Each learning objective is keyed to specific pages in the text and to specific questions and problems that follow. Look at page 2 for examples.

Economic terminology is often an obstacle to new students in economics. Thus the *Key-Term Review* and *Crossword Puzzle* sections of the *Study Guide* provide practice in the use of terminology. Both sections help the students to link economic terms to the appropriate economic concepts. The *Study Guide* reinforces the terminology by repetition. However, we have taken pains not to make the repetition burdensome. The crossword puzzles we have introduced in some of the chapters, for example, help to make the repetition fun.

The *True or False* and *Multiple Choice* sections help the student advance from memorizing terminology to applying economic principles in a familiar problem-solving setting. This will help greatly in their preparation for exams.

The *Problems and Applications* sections let the students discover economic principles for themselves. Students not only learn the techniques that economists use, but they also discover the basis for the economic principles they have learned.

The section called *Common Errors* was introduced in the first edition of this book in 1980, and at that time it was unique to this *Study Guide*. Since then a number of competing books have begun including similar sections, a strong indicator of its usefulness to students and its popularity with instructors. It is our feeling that, semester after semester, students have difficulty with the same concepts and make the same mistakes; hence, the name *Common Errors*. We've tried to draw attention to some of these problem areas and provide explanations using the appropriate economic principles. You may wish to add to those we have provided.

Another unique feature of this *Study Guide* is what we call the "media exercise." The media exercises are contained in the *Problems and Applications* section of each chapter. Each one directs the students to reread a certain newspaper, magazine, or other media article from among those interspersed throughout the text. The students then answer a series of questions based on the article, using the economic principles they have learned in the chapter. The media exercises should help the students see economic principles at work in the world around them, and make them aware of how to get the "economics" out of a critical reading of the "news" long after they leave the economics classroom.

The *Study Guide* provides an alternative to the memorization: it directs the student in applying economic principles. The exercises and crossword puzzles should actually stimulate interest in economics. We have found that our students showed great satisfaction from the discovery of the ideas embedded in the exercises as well as the neatness of completed problems and mathematical calculations. The exercises focusing on current or historic events also generated interest among the students. We also found that our students enjoyed making up their own crossword puzzles.



To the Student

This *Study Guide* is designed to be used with *The Economy Today*, Fifth Edition, by Bradley R. Schiller. Working through the *Study Guide* should reinforce what you have learned in the textbook and help you to recognize economic principles in your daily experiences.

Note the following points in the various sections of each of the chapters:

- The *Quick Review* provides a brief summary of the concepts in the corresponding text chapter. If you are not comfortable with the terminology and concepts in this review, you should reread the appropriate sections of the text chapter.
- The *Learning Objectives* focus on the basic information in each text chapter and provide outlines for material to be covered in the *Study Guide*. The learning objectives are keyed to questions and problems that follow and to pages in the text. If you have difficulty with a particular idea, you can quickly find the text material and review it.
- The *Key-Term Review* and *Crossword Puzzles* give you practice in the use of terminology in the specific chapters. As a learning aid, you are encouraged to write out the definitions of the key economic terms.
- The *True or False* and *Multiple Choice* questions test your understanding of the basic economic principles discussed in the text chapter.
- The *Problems and Applications* section contains one or more real-world problems, which allow you to work out in a practical way the economic principles that you have been studying.
- Nearly all chapters contain a “media exercise” that refers you to specific newspaper, magazine, or other articles reprinted in the text. These exercises will assist you in developing your critical thinking skills.
- The *Common Errors* section identifies some of the errors that students often make and explains the correct principles. This is a very effective way to help you discover and correct your mistakes.
- *Answers to all* problems, exercises, and questions are provided at the end of each chapter of the *Study Guide*, so you can quickly check your answers and go back and review where necessary.



Acknowledgments

This is the fifth edition of the *Study Guide to Accompany the Economy Today*, and over the years, we have accumulated debts to many individuals for their help. We continue to thank the students who endured our testing of the first edition exercises. Their patience, creativity, and critical thinking prompted many of the improvements from which current students still benefit. Some even contributed their own cross-word puzzles. They include Sidi Habi, Patricia Eason, Margaret Gatchell, Louise Oller, and Robin Burdette. Richard Bayer originated two excellent exercises in the macroeconomics section. These contributions have all been retained in every edition.

The teachers enrolled in the 1982 University of Texas at Arlington Summer Institute in Economics worked through the first fifteen chapters of an early draft of the second edition manuscript. The participants are too numerous to cite individually, but their thoroughness is certainly appreciated. Any errors that remain are, of course, our responsibility.

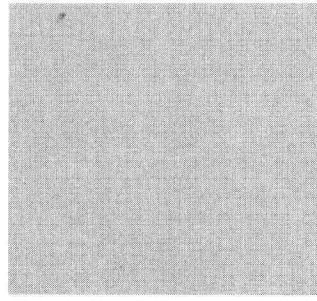
Bryce Jones, professor of economics, and Dan Petree, Dean of the School of Management at Rockhurst College, provided commentary and support, respectively, for this edition, and we are grateful to them both.

We acknowledge the support of the McGraw-Hill staff. They are terrific. We especially thank Jim Bittker, economics editor, for being responsive to our requests and for the calm and friendly manner in which he dispatched his responsibilities. Elaine Rosenberg, editing supervisor, is a real professional. We thank her for her no-nonsense approach and for her skillful management of a difficult project.

Finally, we remember the late Mary Griffin, who was the project editor for the first edition. She was a relentless taskmaster who set high standards for two first-time authors. The typists for the first three editions—Nancy Bloodgood Sproba, Mildred Simms, and Cyndy Carver—were Superb in the days before word processing made the task much easier.

We continue to value the friendship of Paul Shensa, who got us started with Random House over ten years ago.

Michael M. Tansey
Lawrence F. Ziegler



Study Guide to Accompany Schiller:

THE ECONOMY TODAY



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SECTION I Basics

CHAPTER 1

An Overview

Quick Review

The output of the U.S. economy is well over \$5 trillion per year. This is simply the economist's way of summarizing the total volume of goods and services produced in the economy by market participants like you and me. In other words, "The economy is us."

Although our annual production of goods and services is impressive, our resources are not sufficient to satisfy all of our wants. Society's wants are infinite and insatiable while our available resources are relatively fixed. As a result, we (like all societies) are forced to choose which goods and services will be produced and which will not. Economists illustrate these choices by drawing a production-possibilities curve. This curve shows the combinations of goods and services a society could produce if it were operating efficiently and all of its resources were fully employed. The production-possibilities curve appears bowed out from the origin because of the law of increasing opportunity costs.

Every society has to decide what goods and services it wants to produce. In the United States our choices are determined by the market mechanism. Through the market mechanism the production and consumption decisions of individuals directly affect the allocation of resources. These individual decisions are supplemented with generous doses of public-sector activity. When the market mechanism fails to provide goods and services efficiently and equitably—a situation called "market failure"—the public sector must provide assistance. Market systems do not automatically generate pollution-control mechanisms which assure us of clean air and water. Such market imperfections must be overcome by government activity. In some economies the market mechanism has not been allowed to work efficiently. Planned (or command) economies, like that of the Soviet Union, are good examples of this. Even in mixed economies "government failure" can make things worse.

In studying the economy, it is useful to break economics into two categories: microeconomics and macroeconomics. Microeconomics focuses on a specific individual, firm, industry, or government agency; macroeconomics focuses on the entire economy.

Learning Objectives

After reading Chapter 1 and doing the following exercises, you should:

	True or false	Multiple choice	Problems and applications	Common errors	Pages in the text
1. Know what the science of economics is concerned with.	10	1–3,5		2,3	1–8, 15–16
2. Know the factors of production.	2	9		1	6
3. Understand opportunity costs and how to represent them.	1,3,12	6–8	2,3		6–8, 10–12
4. Be able to draw and interpret a production-possibilities curve.	4,16	12,13	1,3		8–14
5. Be able to explain the law of increasing opportunity costs.	11	14	2,3		10–13
6. Know how to represent growth and technological change in terms of shifts of the production-possibilities curve.	13,14	9,10	1		14–15
7. Be able to describe different mechanisms for allocating resources.	6,8	2,4,17,18			15–17
8. Know how the market mechanism allocates resources.	9				15
9. Know several different types of market imperfections.	5,7, 17–19	11			17–18
10. Be able to differentiate between microeconomics and macroeconomics.	15	15,16			20–21
11. Understand the idea of government failure.	20	19			19

Key-Term Review

Review the following terms; if you are not sure of the meaning of any term, write out the definition and check it against the Glossary in the text.

ceteris paribus
economic growth
economics
externalities
factors of production
government failure
law of increasing opportunity costs ✓

macroeconomics
market failure
market mechanism
microeconomics
mixed economy
opportunity cost
production possibilities

Fill in the blank following each of the statements below with the appropriate term from the list above.

- | | |
|--|-----------|
| 1. A Latin phrase meaning “all other things being equal” is _____ | 1. _____ |
| 2. The branch of economics that focuses on the activities of individual decision-making units is _____. | 2. _____ |
| 3. When economists say that to have more schools we must give up houses, they are illustrating the principle of _____. | 3. _____ |
| 4. When market prices signal what goods and services should be produced, the allocation of resources is being accomplished by the _____. | 4. _____ |
| 5. Those things that are transformed into final goods and services desired by society are _____. | 5. _____ |
| 6. The branch of economics that focuses on the behavior of the entire economy is _____. | 6. _____ |
| 7. A curve showing the various combinations of goods and services that a society can produce with its scarce resources is a _____ curve. | 7. _____ |
| 8. The production-possibilities curve is bowed out because of the _____. | 8. _____ |
| 9. When the activity of a producer or consumer imposes costs or benefits on someone else, these costs or benefits are called _____. | 9. _____ |
| 10. The science that studies how societies allocate scarce resources is _____. | 10. _____ |
| 11. Some of the resource allocation in the United States is done through the public sector, indicating that we have a _____. | 11. _____ |
| 12. Where there is an increase in real output there is _____. | 12. _____ |

13. Society's pollution problem is an example of _____ . 13. _____
14. Public-sector intervention that fails to improve economic outcomes is an example of _____ . 14. _____

True or False: Circle your choice.

- T F 1. Students do not pay tuition in elementary school, so in this case education is a free good from society's point of view.
- T F 2. Goods are scarce because society's desire for them exceeds society's ability to produce them.
- T F 3. If a commodity has a market price that is greater than zero, it must be scarce.
- T F 4. A production-possibilities curve can be drawn only if a scarce resource prevents production of as much as we want of a commodity.
- T F 5. The market-directed or price-directed economy is capable of solving the problems created by externalities without intervention by government.
- T F 6. The U.S. economy is referred to as a mixed economy because a large fraction of our resources are allocated by the public sector (government).
- T F 7. When a factory pollutes the air we breathe, this situation is known in economics as an externality.
- T F 8. In the U.S. market system, the government gives the signals for deciding how to use resources.
- T F 9. The distribution of income largely determines the kinds of goods and services the economy will produce.
- T F 10. The task of economic theory is to explain and predict the economic behavior of economic resources.
- T F 11. One reason that the production-possibilities curve is bowed out is that the efficiency with which resources can be used in production varies from industry to industry.
- T F 12. If the economy is fully and efficiently employing its resources, then the only way to acquire more of one good is to accept less of something else.
- T F 13. Technological advance shifts the production-possibilities curve inward.
- T F 14. When the economy experiences declining productivity, then the production-possibilities curve is likely to be shifting inward.
- T F 15. Microeconomics focuses on the economy as a whole.
- T F 16. The slope of the production-possibilities curve is related to the idea of opportunity cost.
- T F 17. Externalities are government failures.
- T F 18. Externalities lead to a mixed economy.
- T F 19. Pollution is an example of market failure.
- T F 20. Inequities can result from either market failure or government failure.

Multiple Choice: Select the correct answer.

- _____ 1. Which of the following best describes the subject matter included in principles of economics?
- (a) How the economy allocates its scarce resources.
- (b) How households make decisions.
- (c) How governments make choices about resources.
- (d) How society purchases resources.

- _____ 2. Which of the following best describes the term “resource allocation”?
- (a) Which goods and services society will produce with available land, labor, and capital.
 - (b) How society spends the income of individuals.
 - (c) How society purchases resources.
 - (d) How one spends one’s income.
- _____ 3. In economics, what does scarcity mean?
- (a) That when there is a shortage of a particular good, the price will fall.
 - (b) That very few buggy whips are being manufactured nowadays.
 - (c) That society’s desires exceed the want-satisfying capability of the resources available to satisfy those desires.
 - (d) None of the above.
- _____ 4. Which of the following *best* describes the way resources are allocated in the U.S. economy?
- (a) By tradition.
 - (b) By command.
 - (c) By markets.
 - (d) By government.
- _____ 5. Which of the following are considered scarce in the U.S. economy?
- (a) Hamburgers.
 - (b) Automobiles.
 - (c) Petroleum products.
 - (d) All of the above.
- _____ 6. I plan on going to a \$5 movie this evening instead of studying for an exam. The total opportunity cost of the movie:
- (a) Depends on how I score on the exam.
 - (b) Is \$5.
 - (c) Is what I could have purchased with the \$5 plus the study time I forgo.
 - (d) Is the forgone studying I could have done in the same time.
- _____ 7. The opportunity cost of installing a traffic light at a dangerous intersection is:
- (a) Negative, since it will reduce accidents.
 - (b) The cost of the stoplight plus the cost savings from a reduction in the number of accidents.
 - (c) The time lost by drivers who approach the intersection when the light is red.
 - (d) The best possible alternative bundle of other goods or services that must be forgone in order to build and install the traffic light.
- _____ 8. The frequently used phrase “time is money” is a way of stating:
- (a) The idea of opportunity cost.
 - (b) Everyone has a price.
 - (c) People work for free.
 - (d) Money is an economic goal.
- _____ 9. Which of the following events would cause the production-possibilities curve to shift *inward*?
- (a) The labor supply grows.
 - (b) New factories are built.
 - (c) A technological breakthrough occurs.
 - (d) None of the above.
- _____ 10. Which of the following events would cause the production-possibilities curve to shift *outward*?
- (a) The economy grows.
 - (b) A new, strong plastic is developed for use in building houses.
 - (c) More women enter the labor force.
 - (d) All of the above would cause such a shift.

- _____ 11. The market mechanism in the United States generates a distribution of income that is viewed as:
- (a) Equal, since everyone gets the same income.
 - (b) Equitable, since public policy does not tamper with it.
 - (c) Both equal and equitable, since they mean the same thing.
 - (d) Inequitable, apparently, since we change it through the activities of the public sector.
- _____ 12. The *slope* of the production-possibilities curve provides information about:
- (a) The growth of the economy.
 - (b) Technological change in the economy.
 - (c) Opportunity costs in the economy.
 - (d) All of the above.
- _____ 13. The bowed-out shape of the production-possibilities curve indicates:
- (a) Increasing opportunity costs.
 - (b) Externalities.
 - (c) Market imperfections.
 - (d) A mixed economy.
- _____ 14. The law of increasing opportunity costs explains:
- (a) How everything becomes more expensive as the economy grows.
 - (b) The shape of the production-possibilities curve.
 - (c) Inflation.
 - (d) All of the above.
- _____ 15. Which of the following are major goals of the economy?
- (a) Full employment.
 - (b) Price stability.
 - (c) An equitable distribution of income.
 - (d) All of the above.
- _____ 16. Macroeconomics focuses on the performance of:
- (a) Individual consumers.
 - (b) Firms.
 - (c) Government agencies.
 - (d) None of the above.
- _____ 17. The most likely source of the failure of Communism in the Soviet Union was the problem of:
- (a) Inadequate land, labor, and capital.
 - (b) Centralization of decision making.
 - (c) Devastation from World War II.
 - (d) The focus on too few social goals.
- _____ 18. The collapse of Communism is evidence of:
- (a) Government failure.
 - (b) Market failure.
 - (c) The failure of a mixed economy.
 - (d) *Ceteris paribus*.
- _____ 19. Which of the following is a government failure?
- (a) Bureaucratic delays.
 - (b) Shortages.
 - (c) Inefficient incentives.
 - (d) All of the above.
- _____ 20. Which of the following groupings contains a word which does not belong?
- (a) Externalities, unfair income distribution, pollution.
 - (b) Public laws (regulation), taxes, centralized government planning.
 - (c) Macroeconomics, microeconomics, mixed economies.
 - (d) Bureaucratic delays, shortages, inefficient incentives.