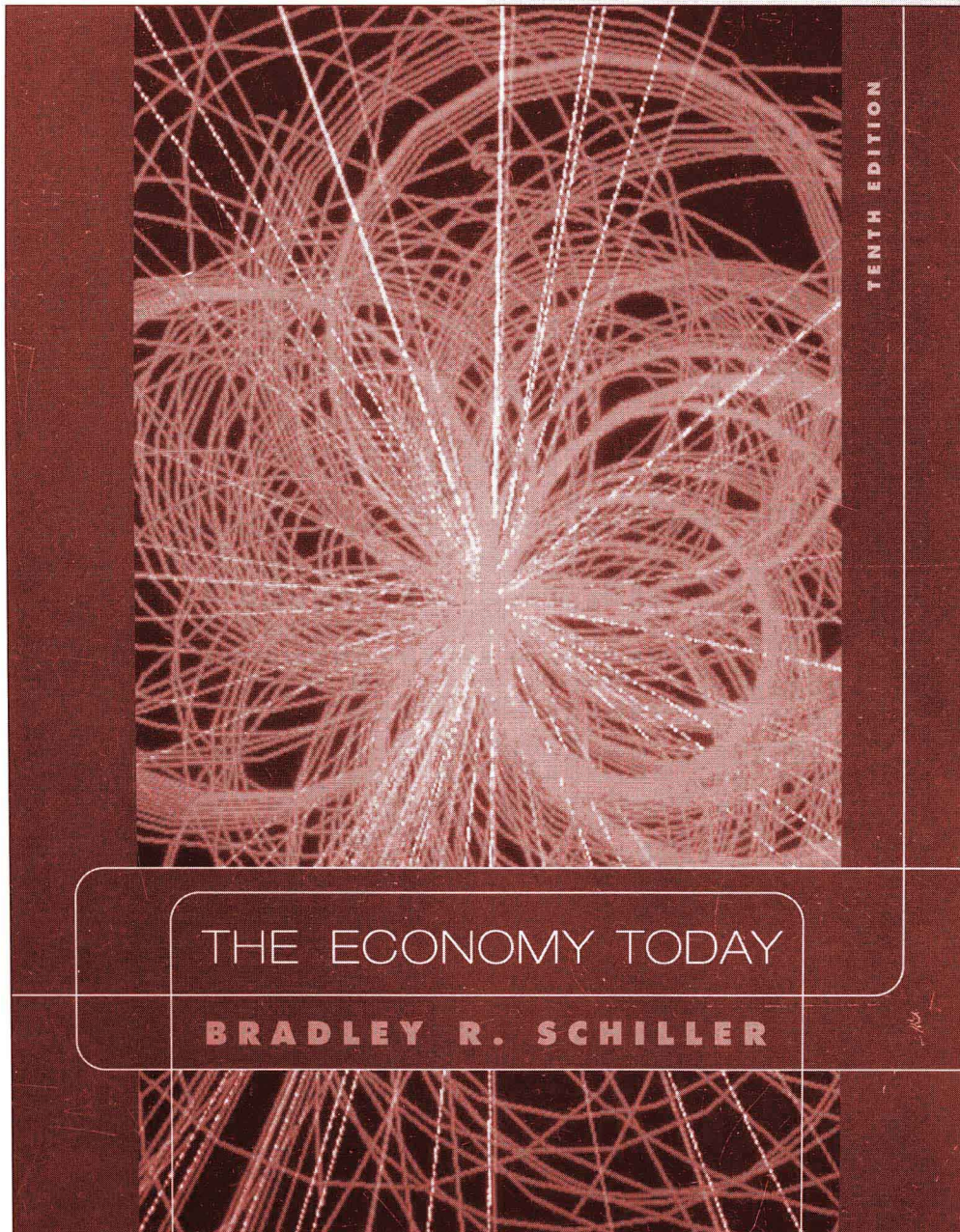


Study Guide

for use with



Prepared by
Linda Wilson
Mark Maier

Study Guide

for use with

The Economy Today

Tenth Edition

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STUDY GUIDE

Preface

This study guide is written to accompany *The Economy Today*, 10th edition, by Bradley R. Schiller. The overall focus of the Study Guide is to reinforce the economic principles and concepts presented in the textbook. Each section of each chapter has a particular objective.

The *Quick Review* and *Learning Objectives* sections provide brief summaries of the basic contents of the corresponding text chapters.

The *Using Key Terms* section allows students to practice using the words defined in each chapter in a crossword puzzle format.

The *True or False* and *Multiple Choice* sections help students apply economic principles in a familiar problem-solving setting. This will help greatly in the preparation for exams.

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

Semester after semester, students have difficulty with the same concepts and make the same mistakes. The section called *Common Errors* addresses some of these problems, and provides an explanation using appropriate economic principles.

STUDY GUIDE

Online Learning Center

The Online Learning Center is an exciting feature of the *The Economy Today's* 10th edition. The Student Center provides a number of ways to supplement your study efforts including Chapter Summaries, Key Terms, Multiple Choice and True or False Quizzes, Web-Based Projects, News Flashes, *New York Times* articles, DiscoverEcon, and PowerPoint slides.

A summary of each feature is provided below along with instructions on how to use it.

Chapter Summary – This is a simple summary of the material covered in the text for each chapter. To access this feature, choose the chapter number you want to work on and then click on the *Chapter Summary* link in the left-hand column.

Key Terms – This section lists the chapter's key terms, and provides a definition for each term. To access this feature, choose the chapter number you want to work on and then click on the *Key Terms* link.

Multiple Choice and True or False Quizzes – There is a 15 question multiple choice quiz and a five question true or false quiz for each chapter. Both quizzes test how well you learned the concepts covered in the chapter. After answering the multiple choice questions, you can submit the quiz for grading and send the results of the quiz to your professor by e-mail. After answering the true or false questions, you are provided with explanations of each questions answer. To access these features, choose the chapter number you want to work on and then click on the *Multiple Choice Quiz or True or False Quiz* link in the left-hand column. After answering the quiz questions, click the "Submit Answers" button to have the quiz automatically graded.

Web-based Activities – There are two interactive activities provided for each chapter. These activities allow you to explore each chapter's content through a series of questions that are tied to specific Internet links. To access this feature, choose the chapter number you want to work on and then click on the *Web-based Activities* link.

Web-based Projects – These projects are designed to help you use the Internet to explore economic questions. In these projects, you are asked a series of questions relevant to the content you are exploring in class. To find the answers, you must explore specific content located on the World Wide Web by following the links provided. These projects also have a collaborative feature that may be assigned by your professor. With this feature you collaborate with other students in your class to develop answers to specific questions together. To access this feature, simply click on the *Web-based projects* link and choose the topic relevant to the material being covered in class or the material assigned by your professor.

NewsFlashes – As up-to-date as *The Economy Today* is, it can't foretell the future. As the future becomes the present, however, Brad Schiller writes 2 page *News Flashes* describing major economic events in the news and relating them to specific text references. To access this feature, simply click on the *NewsFlashes* link and choose the topic relevant to the material being covered in class or the *NewsFlash* assigned by your professor.

New York Times news articles – This section contains news articles from the New York Times that are relevant to the course. To access this feature, simply click on the *New York Times News* link and choose the chapter number you want to work on.

DiscoverEcon with Paul Solman Videos – Software specifically designed to supplement Brad Schiller's *The Economy Today*, 10e was developed by Gerald Nelson at the University of Illinois, Urbana-Champaign. This software is designed to be an interactive textbook that parallels the paper textbook. The software now includes access to over 255 minutes of video created by Paul Solman, economic correspondent for *The News Hour with Jim Lehrer*. These eight to fifteen minute video segments are available via web streaming and can be linked to directly from the DiscoverEcon Video Lab. DiscoverEcon with Paul Solman videos is available with the textbook on the web. When you purchased your new textbook, you should have found an online code card sewn into the front cover of the book. Follow the instructions on the back of the code card to access DiscoverEcon and enter your unique code.

PowerPoints – Developed using Microsoft PowerPoint software, these slides are a great step-by-step review of the key points and graphs in each of the book's 36 chapters. To access this feature, choose the chapter number you want to work on and then click on the *PowerPoints* link in the left-hand column. Click on the chapter file that appears on the screen. It will take a few seconds for your computer to launch PowerPoint, but once you see the first slide, you can begin using the arrow keys to move from slide to slide within the chapter.

If you need additional help, you can click on Help Center to scroll through a list of help topics, or send your question to the webmaster via e-mail by selecting the Feedback option.

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PART 1 Basic Concepts

CHAPTER 1

Economics: The Core Issues

Quick Review

- Resources (land, labor, capital, and entrepreneurship) are considered scarce, even when they seem abundant, because there are not enough resources to satisfy all of society's wants.
- Because resources are limited, society must make choices about what to produce. Choosing to produce one thing means giving up the opportunity to produce something else. Economists refer to the best forgone alternative as opportunity cost.
- 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, which occurs because resources are not equally well suited to the production of all goods.
- If society is inefficient in the use of its resources, it will produce inside the production possibilities curve. Additional resources and technological advances result in an outward shift of the production possibilities curve. This is known as economic growth.
- Every society confronts the problem of scarcity and must somehow answer these basic questions:
WHAT is to be produced?
HOW should it be produced?
FOR WHOM should the output be produced?
- The United States is primarily a market-driven economy. The "invisible hand" of the market mechanism coordinates the production and consumption decisions of millions of individuals and directly affects the allocation of the economy's resources. In some economies the market mechanism is not allowed to work. Planned (or command) economies, such as North Korea, are a good example of this.
- When the market mechanism fails to provide goods and services efficiently and equitably – a situation called "market failure" – the public sector must provide assistance. However, it is possible that government intervention will make the situation even worse, which is referred to as "government failure."

- 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:

1. Understand the debate concerning market allocation vs. government allocation of resources.
2. Understand that economics is the study of how to allocate society's scarce resources – land, labor, capital, and entrepreneurship.
3. Know that scarcity occurs because resources are not sufficient to satisfy all of society's wants.
4. Be able to define and illustrate opportunity costs using a production-possibilities curve.
5. Understand the law of increasing opportunity costs.
6. Be able to demonstrate efficiency, growth, unemployment, and underemployment using a production-possibilities curve.
7. Know why every economy must answer the same basic questions – WHAT, HOW, and FOR WHOM.
8. Be able to distinguish macroeconomic issues from microeconomic issues.
9. Be able to describe how the market mechanism seeks to allocate society's resources to their most valued use.
10. Be aware that there is serious debate and controversy over how the economy works.
11. Be able to discuss the tradeoffs inherent in the "peace dividend."
12. Be able to describe the mixed economy and distinguish market failure from government failure.

Using Key Terms

Fill in the puzzle on the opposite page with the appropriate terms from the list of Key Terms at the end of the chapter in the text.

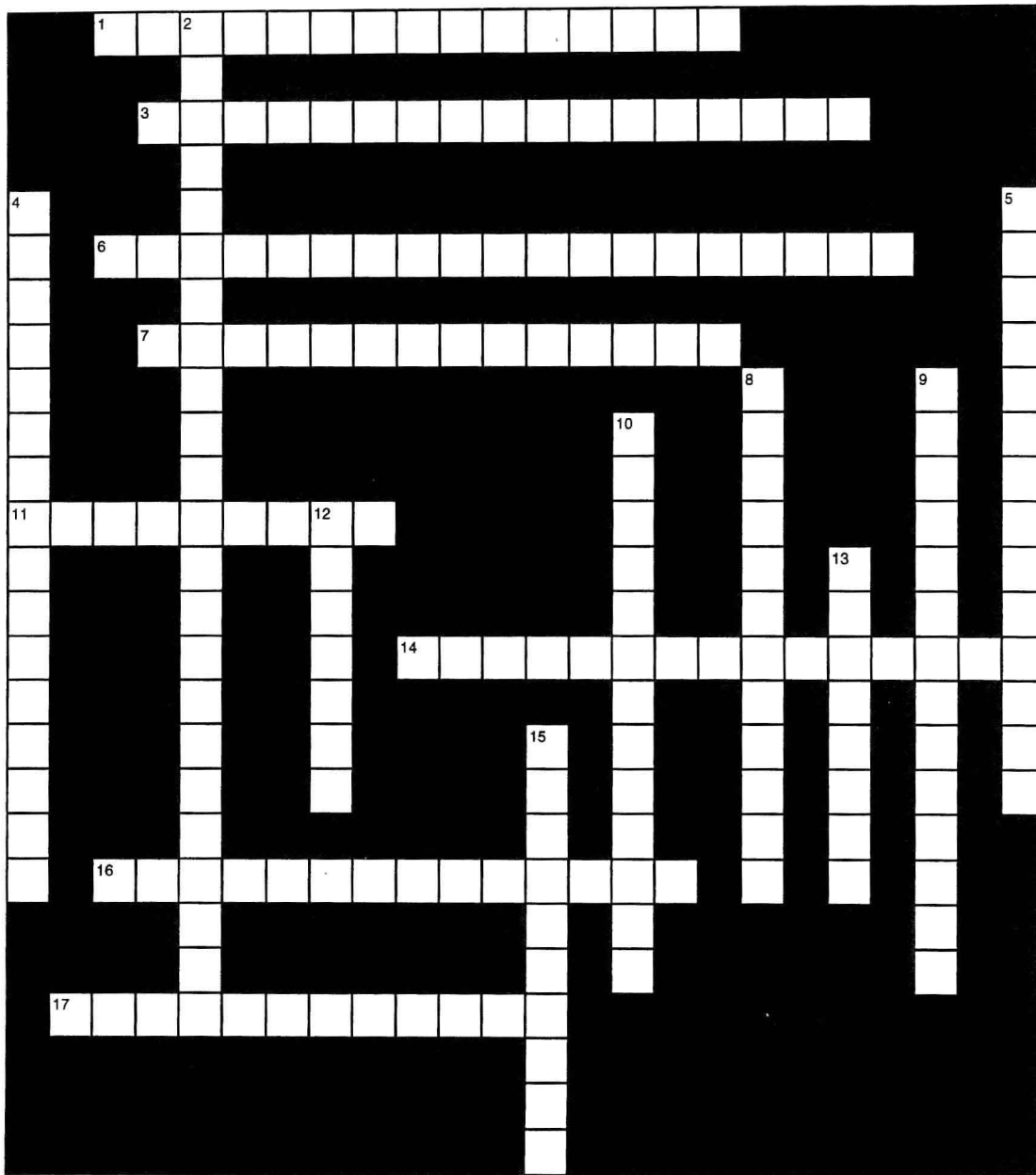
Across

1. The reason there is no such thing as a "free lunch."
3. Occurs when government intervention fails to improve economic outcomes.
6. Represented by land, labor, capital, and entrepreneurship.
7. Economic study concerned with the behavior of individuals, firms, and government agencies.
11. The study of how best to allocate society's scarce resources.
14. Referred to as the "invisible hand" by Adam Smith.
16. Latin term meaning "other things remaining equal."
17. Economic policy supported by Adam Smith.

Down

2. The _____ curve represents the combinations of output that can be produced with the available resources and technology.
4. The individual who brings together the resources needed to produce new or better products.
5. The study of the economy as a whole.
8. The use of both market signals and government directives to select the mix of output.
9. Illustrated in the text by the outward shift of the production-possibilities curve.
10. Occurs when the market mechanism results in the wrong mix of output.
12. Final goods used to produce other goods.
13. The idea that there are not enough resources available to satisfy all desires.
15. Every point on the production possibilities curve represents a situation of _____.

Puzzle 1.1



True or False: Circle your choice and explain why any false statements are incorrect.

- T F 1. Scarcity is only a problem in the very poor countries of the world.
- T F 2. Students do not pay tuition in public school, so from society's point of view, there is no opportunity cost involved in their education.
- T F 3. All output combinations that lie on the production possibilities curve are characterized by efficient use of resources.
- T F 4. One reason that the production possibilities curve is bowed outward is that more production means the economy is less efficient in producing output.
- T F 5. If the economy is fully and efficiently employing its resources, then the only way to acquire more of one good, *ceteris paribus*, is to accept less of something else.
- T F 6. The opportunity cost of a good increases as more of the good is produced because resources are not equally well-suited to the production of all goods.
- T F 7. The economy achieves the greatest efficiency when it is inside the production possibilities curve.
- T F 8. An economy will never be able to produce a combination of goods and services outside of its existing production possibilities curve.
- T F 9. A market-driven economy is not capable of solving the problems created by pollution without intervention by government.
- T F 10. Price signals direct the answers to the WHAT, HOW, and FOR WHOM decisions in a laissez-faire economy.

Multiple Choice: Select the correct answer.

- _____ 1. Which of the following is the best description of the origin of the economic problem of scarcity?
- (a) Humans have limited wants for goods and services and resources are also limited.
 - (b) Humans have limited wants for goods and services and resources are unlimited.
 - (c) Humans have unlimited wants for goods and services but resources are limited.
 - (d) Humans have unlimited wants for goods and services and resources are also unlimited.
- _____ 2. Which of the following best describes the term "resource allocation"?
- (a) Which goods and services society will produce with available factors of production.
 - (b) How society spends the income of individuals based on resource availability.
 - (c) How society purchases resources, given its macroeconomic goals.
 - (d) How individual market participants decide what to produce given fixed resource constraints.
- _____ 3. A consequence of the economic problem of scarcity is that:
- (a) Choices have to be made about how resources are used.
 - (b) There is never too much of any good or service produced.
 - (c) The production of goods and services has to be controlled by the government.
 - (d) The production possibilities curve is bowed outward.

- _____ 4. Which of the following is *not* a factor of production?
- (a) A college professor.
 - (b) A chalkboard used in an economics classroom.
 - (c) The \$10 million donated to the college by wealthy alumni.
 - (d) The land on which a college is located.
- _____ 5. Centrally planned economies are most likely to underestimate the value of:
- (a) Land.
 - (b) Labor.
 - (c) Capital.
 - (d) Entrepreneurship.
- _____ 6. Which of the following describes how resources are typically allocated in the U.S. economy?
- (a) By tradition.
 - (b) By democratic vote.
 - (c) By markets.
 - (d) By government.
- _____ 7. I plan on going to a \$8 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 \$8.
 - (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.
- _____ 8. The opportunity cost of installing a traffic light at a dangerous intersection is:
- (a) Negative, since it will reduce accidents.
 - (b) The best possible alternative bundle of other goods or services that must be forgone in order to build and install the traffic light.
 - (c) The time lost by drivers who approach the intersection when the light is red.
 - (d) The cost of the stoplight plus the cost savings from a reduction in the number of accidents.
- _____ 9. Which of the following events would cause the production possibilities curve to shift inward?
- (a) Immigration into a country increases.
 - (b) New factories are built.
 - (c) A technological breakthrough occurs.
 - (d) A terrorist attack destroys roads, bridges, and factories.
- _____ 10. Which of the following events would cause the production possibilities curve to shift outward?
- (a) The economy's capital stock increases.
 - (b) A new, strong plastic is developed for use in building houses.
 - (c) More women enter the labor force.
 - (d) All of the above.
- _____ 11. 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.
- _____ 12. The law of increasing opportunity cost 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.

- _____ 13. When an economy is producing efficiently it is:
- (a) Producing a combination of goods and services outside the production possibilities curve.
 - (b) Getting the most goods and services from the available resources.
 - (c) Experiencing decreasing opportunity costs.
 - (d) All of the above are correct.
- _____ 14. In a market economy, the answer to the WHAT to produce question is determined by:
- (a) Direct negotiations between consumers and producers.
 - (b) Producer profits and sales.
 - (c) Government directives.
 - (d) A democratic vote of all producers.
- _____ 15. In a market economy, the answer to the HOW to produce question is determined by:
- (a) Government planners.
 - (b) The production possibilities curve.
 - (c) The least-cost method of production.
 - (d) The method of production that uses the least amount of labor.
- _____ 16. The trend toward greater reliance on the market mechanism by former communist societies is evidence of:
- (a) Government failure.
 - (b) Market failure.
 - (c) The failure of a mixed economy.
 - (d) *Ceteris paribus*.
- _____ 17. Which of the following are major macroeconomic goals of the economy?
- (a) Full employment.
 - (b) Control of inflation.
 - (c) Economic growth.
 - (d) All of the above.
- _____ 18. Microeconomics focuses on the performance of:
- (a) Individual consumers, firms and government agencies.
 - (b) Firms only.
 - (c) Government agencies only.
 - (d) The economy as a whole.
- _____ 19. Reread the *World View* article "India's Economy Gets a New Jolt From Mr. Shourie." The article suggests that India has been using its resources inefficiently and operating:
- (a) On the production possibilities curve and near the middle.
 - (b) Outside the production possibilities curve.
 - (c) On the production possibilities curve but near one axis.
 - (d) Inside the production possibilities curve.
- _____ 20. Reread the *World View* article "Food Shortages Plague North Korea." Implicitly, the article is suggesting that the maintenance of an army results in:
- (a) An opportunity cost in terms of consumer goods.
 - (b) An opportunity cost in terms of investment goods only.
 - (c) No opportunity cost because the army keeps the country safe.
 - (d) No opportunity cost because the soldiers are being paid.

[CHAPTER 1 APPENDIX QUESTIONS]

- _____ 21. The slope of a curve at any point is given by the formula:
- (a) The change in y coordinates between two points divided by the change in their x coordinates.
 - (b) The change in x coordinates between two points divided by the change in their y coordinates.
 - (c) The percentage change in y coordinates between two points divided by the percentage change in their x coordinates.
 - (d) The percentage change in x coordinates between two points divided by the percentage change in their y coordinates.
- _____ 22. When the relationship between two variables changes:
- (a) There is movement from one point on a linear curve to another point on the same curve.
 - (b) The entire curve shifts.
 - (c) The labels on the axes must be changed.
 - (d) The curve becomes linear.
- _____ 23. A linear curve can be distinguished by:
- (a) The continuous change in its slope.
 - (b) The same slope throughout the curve.
 - (c) The changing relationship between the two variables.
 - (d) A shift in the curve.

Problems and Applications

Exercise 1

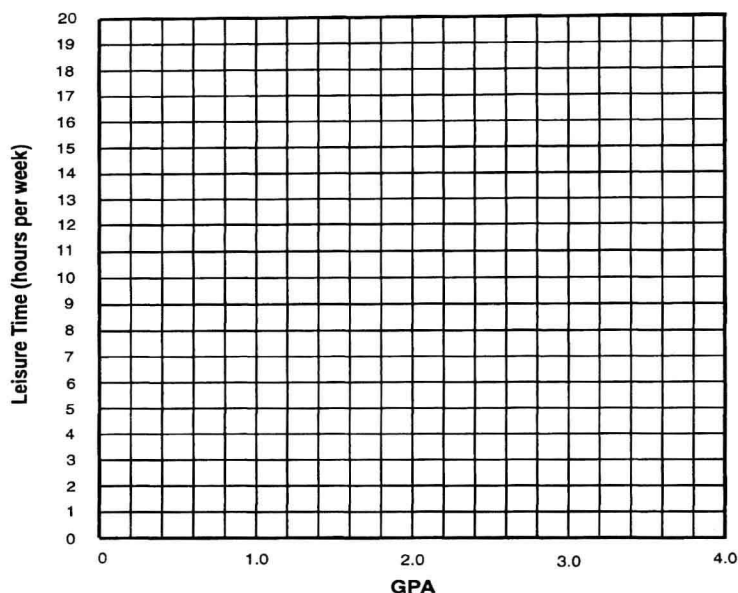
Suppose you have only 20 hours per week to allocate to study or leisure. The following table indicates the tradeoff between leisure time (not studying) and the grade-point average achieved as a result of studying.

Table 1.1

	(a)	(b)	(c)	(d)	(e)
Leisure time (hours / week)	20	18	14.5	10	0
Grade-point average	0	1.0	2.0	3.0	4.0

1. In Figure 1.1, draw the production possibilities curve that represents the possible combinations from Table 1.1.

Figure 1.1



2. Using the information above, what is the opportunity cost of raising your grade-point average from 2.0 to 3.0? _____
3. What is the opportunity cost of raising your grade-point average from 3.0 to 4.0? _____
4. Why does the opportunity cost of improving your grade-point average increase? _____

Exercise 2

This exercise is similar to the problem at the end of Chapter 1 in the text. It provides practice in drawing and interpreting a production possibilities curve and demonstrating shifts of such a curve.

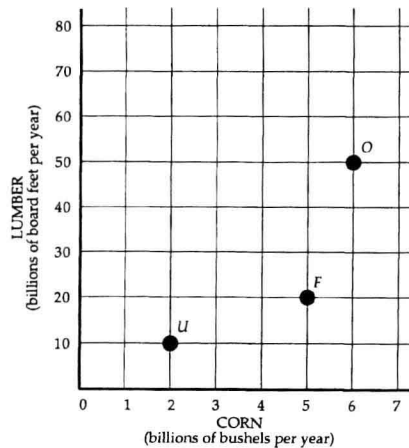
1. A production possibilities schedule showing the production alternatives between corn and lumber is presented in Table 1.2. Plot combination *A* in Figure 1.2 and label it. Do the same for combination *B*. In going from combination *A* to combination *B*, the economy has sacrificed _____ billion board feet of lumber production per year and has transferred the land to production of _____ billion bushels of corn per year. The opportunity cost of corn in terms of lumber is _____ board feet per bushel.

Table 1.2

<i>Combination</i>	<i>Quantity of corn (billions of bushels per year)</i>	<i>Quantity of lumber (billions of board feet per year)</i>
A	0	50
B	1	48
C	2	44
D	3	38
E	4	30
F	5	20
G	6	0

2. In answering question 1, you determined the opportunity cost of corn when the economy is initially producing only lumber (combination A). Using the information in Table 1.2, plot the rest of the production possibilities combinations in Figure 1.2 and label each of the points with the appropriate letter. Connect the points to form the production possibilities curve.

Figure 1.2



3. When Table 1.3 is completed, it should show the opportunity cost of corn at each possible combination of lumber and corn production in the economy. Opposite "1st billion bushels" insert the number of board feet per year of lumber sacrificed when the economy shifts from combination A to combination B. Complete the table for each of the remaining combinations.

Table 1.3

<i>Corn production (billions of bushels per year)</i>	<i>Opportunity cost of corn in terms of lumber (billions of board feet per year)</i>
1st billion bushels	_____
2nd billion bushels	_____
3rd billion bushels	_____
4th billion bushels	_____
5th billion bushels	_____
6th billion bushels	_____

4. In Table 1.3, as more corn is produced (as the economy moves from combination A toward combination G), the opportunity cost of corn (falls; rises; remains the same), which illustrates the law of _____.
5. Suppose that lumber companies begin to clear-cut forest areas instead of cutting them selectively. Clear-cutting improves the economy's ability to produce lumber but not corn. Table 1.4 describes such a situation. Using the information in Table 1.4, sketch the new production possibilities curve in Figure 1.2 as you did the initial production possibilities curve based on Table 1.3. For which combination does clear-cutting fail to change the amount of corn and lumber produced?
- _____

Table 1.4

<i>Combination</i>	<i>Corn (billions of bushels per year)</i>	<i>Lumber (billions of board feet per year)</i>
A'	0	75
B'	1	72
C'	2	66
D'	3	57
E'	4	45
F'	5	30
G'	6	0

6. After the introduction of clear-cutting most of the new production possibilities curve is (outside; inside; the same as) the earlier curve. The opportunity cost of corn has (increased; decreased) as a result of clear-cutting.