ECONOMICS OF SOCIAL ISSUES

Eleventh Edition

SHARP
REGISTER
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Economics of Social Issues

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Preface

The objectives and the orientation of the eleventh edition of *Economics of Social Issues* remain the same as in previous editions. Our objectives are to (1) create student interest in the study of economics and (2) provide a framework of basic analytical tools useful in the analysis of social problems. To reach these objectives, we first introduce and discuss an issue. Next, we develop the economic concepts and principles germane to the issue and then apply these principles to the issue in order to discover if there are ways in which they can help us resolve it. The arrangement of the issues in the book is planned to provide a logical development of basic economic concepts and to reinforce understanding of these concepts through repeated use and application. As always, we are concerned about the timeliness of our issues and their usefulness in helping students learn the important basic principles of economics.

New Features

There are numerous changes in this edition of our book. The most significant is the new chapter on the economics of professional sports. This chapter was authored by Paul W. Grimes of Mississippi State University. Paul also made helpful suggestions for the rest of the text as well. Throughout the text, we have converted, where possible, to the use of the term *gross domestic product* and included a discussion of it and how it differs from gross national product in Chapter 1. In this edition, we have moved the discussion of the price eleasticity of demand from Chapter 2 to Chapter 3. Chapter 3, with its emphasis on the economics of higher education, provides a natural application for the elasticity material. Specifically, in addition to discussing the economic implications of differential tuition based on differences in demand, we now are able to consider differential tuition based on relative demand elasticities and its impact on revenues. Given the general stability of the world oil market, the previous edition's chapter on energy problems has been omitted. We have added discussions of proposed health care reforms such as managed competition in Chapter 10. Chapter 13 now includes a discussion of the macroeconomy in the early 1990s and considers the need for a stimulus package as proposed by President Clinton. A new section in Chapter 15 introduces President

Clinton's proposed tax changes. This includes a discussion of both the changes to deal with deficit problems and universal health insurance. Chapter 16 now contains a discussion of the federal budget deficit. As always, the data are thoroughly updated as are the citations and examples, where appropriate.

We would like to express our thanks to the many users who have taken time to send us their comments and to the reviewers who have provided us with detailed comments and suggestions to improve previous editions. Many of the new features of this edition are based on the suggestions that have been made to us in conversation or in writing by the following users or reviewers of our book:

John Altazen, *University of New Orleans*; Michael W. Babcock, *Kansas State University*; Walter Baumgartner, *SUNY–Oneonta State College*; David Blanchard, *University of Wisconsin–Oshkosh*; Basil Cooil, *Tompkins Cortland Community College*; Harry L. Cook, *Southern Oregon State College*; Edward J. Deak, *Fairfield University*; James H. Dukes, *University of West Florida*; Allen Early, *West Texas State College*; James Gapinski, *Florida State University*; David E. R. Gay, *University of Arkansas*; George H. Hand, *Southern Illinois University*; Sydney Hicks, *Interfirst Bank of Dallas*; Doug Hodo, *University of Texas–San Antonio*; William W. Howard, *Phoenix College*; John Jambura, *Eastern Oregon State College*; Barry Krissoff, *Western Michigan University*; Howard D. Leftwich, *Oklahoma Christian College*; E. Victor Maafo, *North Carolina Central University*; Thomas McCann, *Northeastern Louisiana University*; James McLain, *University of New Orleans*; Douglas McNeil, *McNeese State University*; Jim Mangum, *Louisiana Tech University*; James Marsden, *University of Kentucky*; Charles Meyerding, *Inver Hills Community College*; Thomas M. Mitchell, *Southern Illinois University at Carbondale*; Jeff Moore, *University of Houston*; Clair E. Morris, *United States Naval Academy*; Roland Mullins, *Arkansas State University*; Dave Nagao, *Sacramento City College*; Ken Nair, *West Virginia Wesleyan University*; John Neal, *Lake-Sumter Community College*; Thomas Parsons, *Massachusetts Bay Community College*; Michael Sattinger, *SUNY at Albany*; Harold M. Seeberger, *Heidelbert College*; Robert Smith, *Louisiana State University*; Gary L. Stone, *Winthrop College*; Philip F. Warnken, *University of Missouri*; and Shiu-fang Yu, *Texas State University*.

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Human Misery

The Most Important Issue of Them All

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"I can't stand up," mutters Yussef Sheik Hussein, ignoring the swirl of flies attracted to a half-dozen dying Somalis nearby. "Do you have some medicine?" Hussein's emaciated body seems disconnected from his chiseled, intelligent face. But his eyes and memories are clear: His 75-acre farm was overrun by marauding gunmen a year ago; six sons and one daughter are all dead now. "Some were killed in fighting, and the smallest died of hunger." Without the needed medicine, his own fate is painfully clear. Beyond his hospital window, one of the morning's many dead is loaded on a donkey cart and led away.

Outsiders peer into such tortured lives feeling like ghoulish voyeurs. The initial impulse is to turn away. What, after all, can be done for people living in hell? Skeletal figures wander the thorny landscape in search of food, sometimes taking shelter in abandoned government buildings stripped bare by looters. Starvation has already claimed 100,000 lives and more than a million others could follow.[1]

[1]Jeffrey Bartholet, "The Road to Hell," *Newsweek*, September 21, 1992, pp. 53–57. © 1992, Newsweek, Inc. All rights reserved. Reprinted by permission.

World Poverty and Economics

Some two thirds of the world's population go to sleep hungry at night. The World Bank estimates that perhaps as much as one quarter of the world survives on no more than $1 per day. Outright famine regularly occurs in various parts of the world—recent examples being the mass starvation of an estimated 1 million people in Ethiopia during the drought of 1984–85 and the contemporary tragedy of perhaps even greater proportions in Somalia. Most of the hungry have no protection from the summer's heat or the winter's cold. They receive little or no medical care and live in unsanitary surroundings. Infant mortality is high and life expectancy is low. While in the United States 9 infants die before reaching their first birthday out of each 1,000 live births, the rate explodes to well over 1 in 10 in places such as Ethiopia, Pakistan, and Tanzania. At the opposite end of life, the typical Ethiopian can expect to die about 30 years earlier than his or her contemporary in the United States. Recognition that the misery of poverty is the lot of the largest part of the world's population leads us to ask the questions: Why is it so? What are the causes? How can it be alleviated? This in turn leads us directly into the province of economics. An assessment

and analysis of poverty problems require an explicit understanding of the very foundations of economic activity. In this section, we sketch out its fundamental aspects.

Our Insatiable Wants

Economic activity springs from human wants and desires. Human beings want the things necessary to keep them alive—food and protection from the elements of nature. We usually want a great many other things, too, and the fulfillment of these wants and desires is the end toward which economic activity is directed.

As nearly as we can tell, human wants in the aggregate are unlimited or insatiable. This is true because once our basic needs are met, we desire variety in the way they are met—variety in foods, in housing, in clothing, and in entertainment. Additionally, as we look around, we see other people enjoying things that we do not have (digital audio equipment and home computers, for example), and we think that our level of well-being would be higher if we had those things, too. But most important, want-satisfying activity itself generates new wants. A new house generates wants for new furnishings—the old ones look shabby in the new setting. A college or university education opens the doors to wants that would never have existed if we had stayed on the farm or in the machine shop. To be sure, any one of us can saturate ourselves—temporarily, at least—with any one kind of good or service (like ice cream or beer), but almost all of us would like to have more than we have of almost everything and higher qualities of purchases than we now can obtain.

Our Limited Means

The fundamental economic problem is that the means available for satisfying wants are *scarce* or limited relative to the extent of the wants. The amounts and qualities of goods and services per year that an economic system can produce are limited because (1) the resources available to produce them cannot be increased by any great amount in any given year and (2) the technology available for production is subject to a limited degree of annual improvement.

An economy's *resources* are the ingredients that go into the making of goods (like automobiles) and services (like physical examinations). Production is similar to cooking. Resources (ingredients) are brought together; technology is used to process these resources in certain ways (mixing and cooking them), and finally a good or service results (a cake, perhaps). Some outputs of production processes are used directly to satisfy wants. Others become inputs for additional production processes. The resources available in an economy are usually divided into two broad classifications: (1) labor and (2) capital.

Labor resources refer to the physical and mental efforts of an economy's people that are available to produce goods and services.

Labor resources consist of all the efforts of mind and muscle that can be used in production processes. The ditch digger's output along with that of the heart surgeon and the university professor is included. There are many kinds and grades of labor resources; their main common characteristic is that they are human.

Capital resources refer to all the nonhuman ingredients of production such as land, buildings, machinery and equipment, and semifinished materials.

Capital resources consist of all the nonhuman ingredients that go into the production of goods and services. They include land that provides space for production facilities, elements that enable it to grow crops, and many useful mineral deposits. They also include buildings and equipment that have been built up over time, along with the economy's stock of tools. In addition, all of the raw and semifinished materials that exist in the economy at any given time and that are available for use in production are capital resources. Sheets of steel and grocery store inventories are examples of semifinished materials.

Resources are always scarce relative to the sum total of human wants. Consider the U.S. economy. The U.S. population is about 250 million. Most U.S. citizens want more things than they now have. Can the economy increase next year's production enough to fulfill all of these wants? Obviously not. The labor force available from the present population cannot be increased substantially in either quantity or quality very quickly. Both may be increased over time by increasing the size of the population and through improving the education and training of the general population, but this increases total wants, too. The stocks of buildings, machines, tools, raw and semifinished materials, and usable land are not susceptible to rapid increases either; instead they are accumulated slowly over time.

Technology refers to the know-how and the means and methods of production available within an economy.

Technology refers to the known means and methods available for combining resources to produce goods and services. Given the quantities of an economy's labor and capital resources, the better its technology, the greater is the annual volume of goods and services it can turn out. Usually improvements in technology in an economic system result from increasing the scope and depth of its educational processes and from an ample supply of capital that provides a laboratory for experimentation, practice, and the generation of new ideas.

The Capacity of the Economy to Produce

Gross domestic product (GDP) measures the market value of all final goods and services produced within an economy during one year. GDP ignores the issue of whether the resources used for the production are domestically or foreign owned.

Gross national product (GNP) measures the market value of all final goods and services produced by domestically owned resources during one year regardless of where the production takes place.

Gross Domestic Product and Gross National Product. Given the fundamental problem of scarcity that all societies face, it is essential that we be able to track how well a particular economy translates labor and capital resources into goods and services. In general terms, we wish to be able to quantify the total dollar value of all final goods and services produced. Two measures of the value of production are commonly employed: *gross domestic product*, or GDP, and *gross national product*, abbreviated as GNP.

While not identical, each measures the economy's annual output of final goods and services. The difference between the two measures is best understood by considering two related questions. When Toyota produces its popular Camry in Georgetown, Kentucky, should such production be considered part of U.S. output? Conversely, when Chevrolet builds its popular Camaro in Canada, should this production be part of U.S. output? The answer to each question is the same; "yes" and "no" depending on whether one is considering GDP or GNP. If the focus is on GDP, it makes no difference who owns the production facilities; if the production takes place in the United States, it is counted towards U.S. output. Thus, GDP includes the value of the Camrys produced in Kentucky and excludes the value of the Canadian-built Camaros. On the other hand, GNP focuses on the output derived from domestically owned resources and, consequently, would include the value of the Camaros but not that of the Camrys. Put simply then, GDP measures the market value of the annual output of final goods and services produced within an economy, while GNP measures the market value of the annual output of final goods and services produced using domestically owned resources. Given this difference, during any particular year GDP may be greater than, less than, or equal to GNP. While each is a valid measure of national production, we will follow, where possible, the U.S. government's convention and employ GDP as our measure of production.

Production Possibilities. Given an economy's available stocks of resources and its level of technology, there are any number of combinations of goods and services that can compose its GDP. For simplicity, suppose that it produces only two items—bread and milk—and that all of its resources are devoted to the production of these two products. The curve *AE* in Figure 1–1 represents all possible combinations of bread and milk that can be produced. It is appropriately called the economy's *production possibilities curve.* Thus, GDP may consist of 100,000 loaves of bread per year with no milk as shown by point *A*, or 100,000 quarts of milk per year with no bread as shown by point *E*. Or it may consist of any combination on the curve, such as *B*, containing 90,000 loaves of bread and 40,000 quarts of milk; or *C*, containing 50,000 loaves of bread and 80,000 quarts of milk; or some combination under the curve such as *F*, containing 50,000 loaves of bread and 40,000 quarts of milk.

The **production possibilities curve** represents the maximum quantities of two goods and/or services that an economy can produce when its resources are used in the most efficient way possible.

If an economy's GDP is some combination of goods and services like *F*, which lies below its production possibilities curve, the economic system is not operating efficiently. Some of its resources may be unemployed, used in the wrong places, or wasted. It also may not be using the best available techniques of production.

Combinations of goods and services, like *G*, lying above the production possibilities curve, are not currently attainable. The economy

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