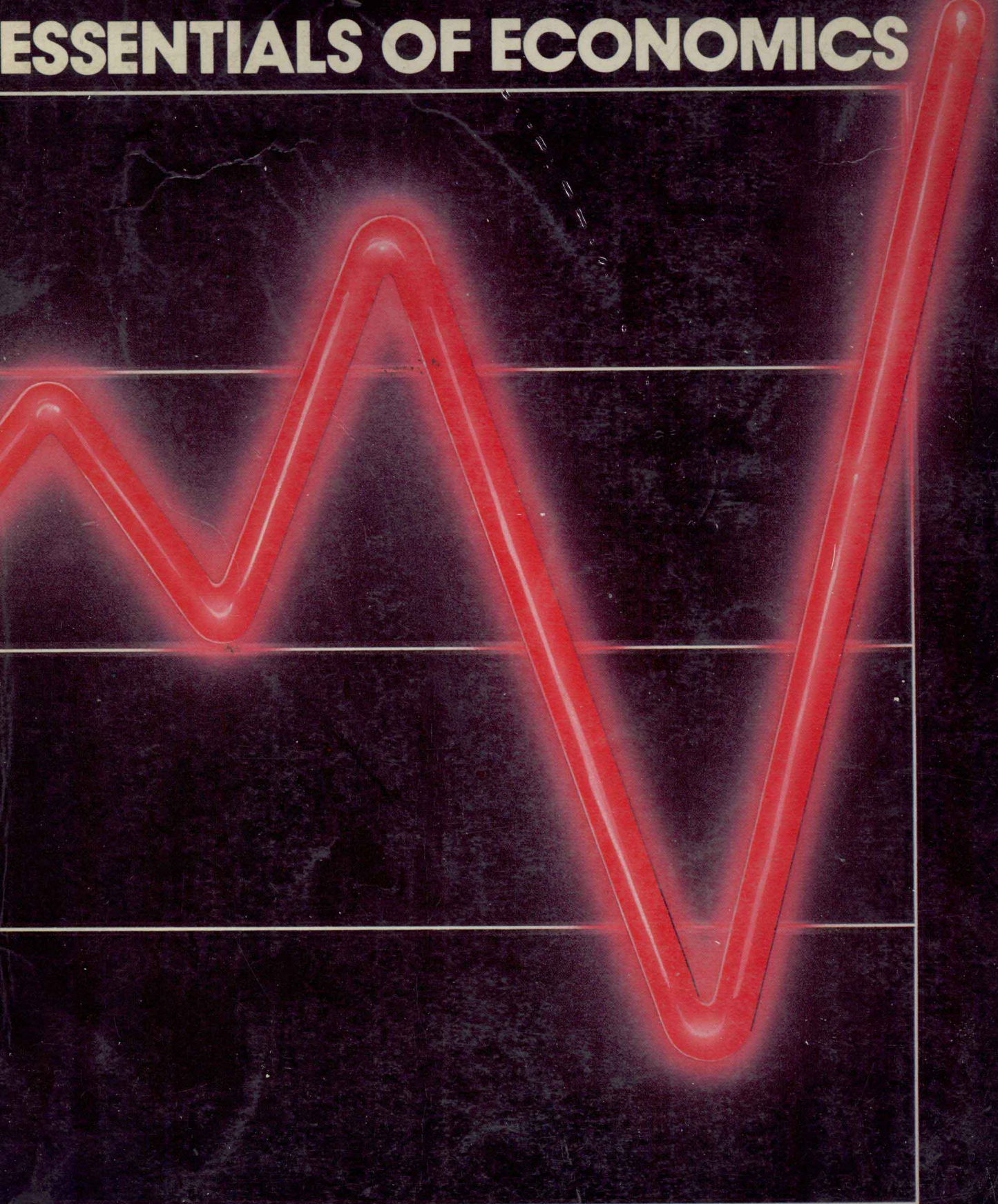


ESSENTIALS OF ECONOMICS



GWARTNEY • STROUP • CLARK

ESSENTIALS OF ECONOMICS

JAMES D. GWARTNEY
Florida State University

RICHARD STROUP
Montana State University

J. R. CLARK
Fairleigh Dickinson University

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Essentials of Economics is a text designed specifically for a one-term course in economics. This one-term course takes many shapes and forms as it is taught throughout the United States. Many students will take the course as their only exposure to economics in an entire college career. Another, but significantly smaller group, will take the one-term course as a stepping stone to a full year principles course or perhaps even more advanced study in economics. With this wide variety of audiences, it is difficult for a text to be all things to all people. *Essentials of Economics* has been designed with a very definite set of goals for this course in mind.

First, the text is definitely analytical. Unfortunately, some survey courses skirt the issue of teaching the economic way of thinking and simply attempt to acquaint the student with fact and fiction about economics. *Essentials of Economics* stresses that human decision-makers respond to incentives and very carefully traces out the analytical processes that guide decision-makers in their choices. The text is not a random walk through economics, but a very specific guided tour that teaches students to view human interaction through the eyes of the economist. It teaches economics as a method of inquiry and a tool to greater understanding of how and why human beings make choices at both the individual and societal levels.

Second, *Essentials of Economics* is one of a very few texts that provide students with basic information about political economy and the choice process of the public sector. Often, economics courses will examine the choices of individuals as if the decision process of the entire society was identical. This text does trace out the micro foundations of macro theory, but it also provides students with an excellent section on contemporary public choice theory. The growth in this area of economics has been substantial in the last decade, placing it rightfully in the mainstream of a successful introductory economics course. Students taking economics today may be ill-prepared to understand the political realities of economic theory in years to come if we do not begin to integrate public choice theory into the survey course now.

Third, we are clearly in an era of changing emphasis on such important topics as government regulation, corporate and personal tax structures and incentives, environmental concerns, property rights, and supply side economics in general. It is even more important in such times to provide an overall explanatory framework to students that will tie together these diverse topics (diverse in the

minds of students), and enable the student to see the obvious interrelationships. The seven guideposts to economic thinking and their application to subsequent chapters material performs this umbrella function. If students learn nothing more than the guideposts and are able to apply them, it will have been a substantial step forward in their thought process.

DISTINGUISHING FEATURES

We have employed several features of organization and design in order to make this presentation more interesting to students.

1. *Myths of Economics.* In a series of boxed articles, six commonly held fallacies of economic reasoning are refuted. Following a statement of each myth is a concise explanation of why it is incorrect. Each myth falls in a chapter containing closely related material.
2. *Perspectives in Economics.* These features, whose purpose is to demonstrate the applications of economics, present a detailed analysis of current topics. When solid, well-founded arguments favor both sides of a given point, the alternative viewpoints are presented and contrasted. Use of this material as a teaching aid has shown that it helps to stimulate student interest and discussion and encourages students to develop the economic way of thinking. Set off in a light tint, these two-column Perspectives are included in chapters in which related material is introduced.
3. *Outstanding Economists.* Designed to foster the student's lasting interest in economics, these articles present brief profiles of economists who have made major contributions to the field or are currently influencing economic thought. Although contemporary economists (for example, Kenneth Arrow, John Kenneth Galbraith, and Joan Robinson) are emphasized, such giants of economics history as Adam Smith, David Ricardo, and Alfred Marshall are also included. This series should serve both to enhance the student's appreciation of economic history and to signify the contributions of many prominent present-day economists.
4. *Boxed Features.* Throughout the text, many short essays addressing topics of current concern and providing detailed illustrations of major concepts are presented in three-column boxes. These articles offer a "point of view" on items of new interest and often elucidate both the ramifications of economic policy-making and the behavior of market participants.
5. *Key Terms and Chapter Learning Objectives.* These two features are designed primarily to enhance the learning of important concepts. Key terms are introduced in the text in boldface type; simultaneously, each term is defined in the margin opposite the first text reference to the term. A statement of learning objectives composed of the major concepts discussed, follows the text of each chapter. Students are encouraged to study the learning objectives after reading each chapter.
6. *Discussion Questions and Hints for Answering Them.* Intended to test the student's grasp of the economic way of thinking, a set of discussion questions concludes many chapters; students can refer to the Hints for Answering Discussion

Questions (at the back of the book) for selected answers. These questions, and the discussions they provoke, provide students with the opportunity for self-testing and the review of important material.

SUPPLEMENTARY MATERIALS

The textbook is accompanied by a *Study Guide*. More than *just* a study guide, it contains numerous true–false, multiple-choice, and discussion questions; problems (for more detailed analysis) and projects are also suggested. Some chapters contain a short article designed to supplement the classroom teaching of the important concepts presented in the text. In this series of readings, contrasting positions are often presented. Discussion questions follow each article, challenging students to demonstrate their understanding of the material and to distinguish a sound argument from economic nonsense. As in the textbook, the emphasis is on helping the student to develop the economic way of thinking.

An *Instructor's Manual and Testbank* is also available. Divided into three sections, this supplement provides (a) suggested teaching tips and information on data sources, (b) a comprehensive testbank containing more than 1000 multiple-choice test questions, and (c) a detailed outline of each chapter in lecture note form.

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Having thanked those involved, it is traditional for authors to accept responsibility for any errors that remain, I will do so in part. I suggest, however, that with so many distinguished people offering advice and assistance, the probability is very high that I got some bad advice somewhere along the way.

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ESSENTIALS OF ECONOMICS

PART ONE

THE ECONOMIC WAY
OF THINKING—
AN INTRODUCTION

THE ECONOMIC APPROACH

It [economics] is a method rather than a doctrine, an apparatus of the mind, a technique of thinking which helps its possessor to draw correct conclusions.

[J. M. Keynes]

WHY ECONOMICS?

As each of you faced the chore of making your college course selections, you probably realized very quickly that there is an overwhelming array of class offerings available to you. Since you could no more take every course in the catalogue than you could eat every food on a restaurant's menu, you had to decide which courses would probably give you the tools and information that will be most useful to you. And you have chosen economics—a wise decision because economics is the science of making choices, and, as such, it directly affects the life of every individual every day.

Over 30 years ago, John Maynard Keynes wrote

The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually slaves of some defunct economist.

Keynes statement is more true today than ever before. Because of scarcity, individuals and entire nations must make choices. With every choice there is also an opportunity cost. Your choosing to study economics, for example, carries with it the opportunity cost of your not being able to use that same time period to learn about something else. However, your understanding of economics will enable you to make more effective basic choices of all kinds because you will now be able to weigh the opportunity costs and potential benefits of each alternative, and make your choices accordingly.

The course of history is determined by choices—either those made individually through private choice, or by whole societies through public choice. Different nations or economies use different balances of public and private choice, but they must all choose in some manner. The basic economic questions of what to produce, how to produce, and for whom to produce are influenced

every day both by individual decisions in the market place and social decisions in the voting booth.

Until the 1970s, the study of the principles of economics in the United States focused primarily on private choice. In this course, you will learn not only how individual choice affects the economy, but also how individual choice is transformed into social action. You will learn enough about economics to help you make more informed decisions on your own, and to understand the choice-making processes of other individuals and economies. We know of no more efficient way for you to enhance your effectiveness as a consumer, a producer, and a voter than through an understanding of the essentials of economics.

WHAT IS ECONOMICS ABOUT?

Scarcity: Fundamental concept of economics which indicates that less of a good is freely available than consumers would like.

Economic good: A good that is scarce. The desire for economic goods exceeds the amount that is freely available from Nature.

The two basic ingredients of an economic topic are scarcity and choice. **Scarcity** is the term used by economists to indicate that man's desire for a "thing" exceeds the amount of it that is freely available from Nature. Since the Garden of Eden, Nature has dealt grudgingly with man. Nature provides much less of many, many things than man would like to have.

A good that is scarce is called an **economic good**. The first column of Exhibit 1 contains a partial listing of scarce or economic goods. The list includes food, clothing, and many of the items that all of us commonly recognize as material goods. But it also includes some items that may surprise you. Is leisure a good? Would you like to have more leisure time than is currently available to you? Most of us would. Therefore, leisure is a scarce good. What about clean air? A few years ago many economics texts classified clean air as a free good, a good that Nature had made available in such abundant supply that everybody could have as much of it as they wanted. This is no longer true. Our utilization of air for the purpose of waste disposal has created a scarcity of clean air. Many of the residents of Los Angeles, New York, Chicago, and other large cities would like to have more clean air.

Few of us usually think of environmental conditions as economic goods. However, if you are someone who would like more open spaces, green areas, or dogwood trees, you will recognize that these things are scarce. They, too, are economic goods.

Time is also an economic good. Most of us would like to have more time to watch TV, take a walk in the woods, do our school work, or sleep; but we each have only 24 hours in a day. The scarcity of time imposes a definite limitation on our ability to do many of the things we would like to do.

Since scarcity of productive resources, time, and income limit the alternatives available to us, we must make choices. **Choice** is the act of selecting among restricted alternatives. A great deal of economics is about how people choose when the alternatives open to them are restricted. The choices of the family shopper are restricted by the household budget. The choices of the business decision-maker are restricted by competition from other firms, the cost of productive resources, and technology. The choices of the political decision-maker are restricted by the taxable income of the citizenry and voter opposition to taxes.

Choice: The act of selecting among alternatives.

EXHIBIT 1 A General Listing of Desired Economic Goods and Limited Resources

<i>Economic goods</i>	<i>Limited resources</i>
Food (bread, milk, meat, eggs, vegetables, coffee, etc.)	Land (various degrees of fertility)
Clothing (shirts, pants, blouses, shoes, socks, coats, sweaters, etc.)	Natural resources (rivers, trees, minerals, oceans, etc.)
Household goods (tables, chairs, rugs, beds, dressers, television, etc.)	Machines and other man-made physical resources
Space exploration	Nonhuman animal resources (cattle, horses, buffalo, etc.)
Education	Technology (physical and scientific “recipes” of history)
National defense	Human resources (the knowledge, skill, and talent of individual human beings)
Recreation	
Time	
Entertainment	
Clean air	
Pleasant environment (trees, lakes, rivers, open spaces, etc.)	
Pleasant working conditions	
More productive resources	
Leisure	

Our history is a record of our struggle to transform available, but limited, resources into things that we would like to have—economic goods.

The selection of one alternative generally necessitates the foregoing of others. If you choose to spend \$10 going to a football game, you will have \$10 less to spend on other things. Similarly, if you choose to spend an evening watching a movie, you must forego spending the evening playing ping pong (or participating in some other activity). You cannot have your cake and eat it, too.

Each day, we all make hundreds of economic choices, although we are not normally aware of doing so. The choice of when to get up in the morning, what to eat for breakfast, how to travel to work, what television program to watch—all of these decisions are economic. They are economic because they involve the utilization of scarce resources (for example, time and income). We all are constantly involved in making choices that relate to the subject matter of economics.

OUR LOSING STRUGGLE WITH SCARCITY

Scarcity restricts us. How can we overcome it? **Resources**, including our own skills, can be used to produce economic goods. Human effort and ingenuity can be combined with machines, land, natural resources, and other productive factors (see the second column of Exhibit 1) to increase the availability of economic goods. These are our “tools” in our struggle with scarcity. It is important to note that most economic goods are not like manna from heaven. Human energy is nearly always an ingredient in the production of economic goods.

Resource: An input used to produce economic goods. Land, labor skills, natural resources, and capital are examples.