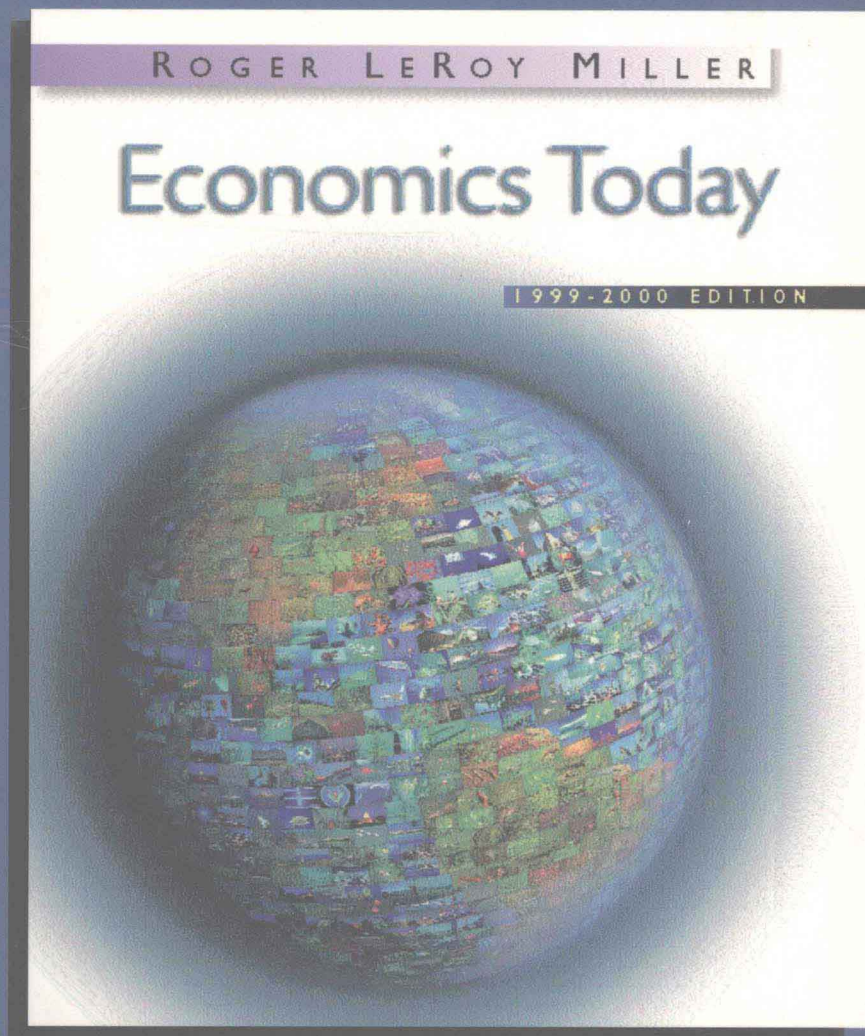


# STUDY GUIDE

TO ACCOMPANY

# ECONOMICS TODAY

1999–2000 Edition



ROGER LEROY MILLER  
ROBERT W. PULSINELLI

# Study Guide

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to Accompany

## *Economics Today* 1999-2000 Edition

by

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# TO THE STUDENT

This *Study Guide* is designed to help you read and understand *Economics Today*, 1999-2000 Edition. Lesson one in economics is that nothing is free; a price must be paid for every activity that is performed and for every good or service that is obtained. The price that you must pay to learn economics certainly includes the course tuition and the costs of your textbook and this *Study Guide*. The price for learning economics also includes the time and effort that it will take you to read and think about this discipline. But the benefits are, potentially, enormous.

If you really learn economics you will achieve your immediate objective, which is (presumably) to make a good grade. More importantly—for the long run—if you learn to think like an economist, you will gain some very crucial insights into human behavior. You should never forget that economics is, first and foremost, a study of human behavior. An understanding of human behavior is a necessary prerequisite to attaining your personal goals and to fulfilling any goals that you might have of helping other people. Good intentions are not enough; if you really want to help people you must understand how they are likely to respond to specific policies. And economics has proven to be an invaluable aid in understanding human motivation.

## HOW THIS *STUDY GUIDE* CAN HELP YOU

This student guide can help you to maximize your learning, subject to constraints on the amount of time that you can allot to this course. There are at least five specific ways in which you can benefit from this guide.

- (1) The *Study Guide* can help you decide what topics are the most important. Because there are so many topics analyzed in each chapter (in *all* principles of economics textbooks) many students become confused about what is essential and what is not. You can't learn everything; the *Study Guide* can help you concentrate on the crucial topics in each chapter.
- (2) If you are forced to miss a class or two (we strongly recommend that you attend class regularly, but we realize that emergencies do arise), you can use this *Study Guide* to help you learn the material discussed in your absence.
- (3) There is a good chance that the questions you are required to answer in this *Study Guide* are representative of the types of questions that you will be asked during examinations.
- (4) You can use this *Study Guide* to help you review for exams.
- (5) Finally, this *Study Guide* can help you decide whether you really do understand the material. Don't wait until exam time to find out!

Ultimately, the way to learn economics is by reading your textbook and *thinking about the theories*. You should try to express the analysis in your own words and to apply the theory to real world circumstances. This *Study Guide* can't teach you to think like an economist—you'll have to learn to do that on your own. It can, however, provide feedback on your progress; if you can answer the questions and solve the problems, then you will know that you are on the right path.

## THE CONTENTS OF THE *STUDY GUIDE*

Economics is considered to be a rather difficult subject because (a) it is theoretical in nature, (b) it uses a specialized jargon, or vocabulary, and (c) it takes (most people) much time and effort to learn. We who are economists, however, believe that our discipline is exciting and provides tremendous insights into human behavior. Your text and this *Study Guide* have been written for the precise purpose of helping you to learn economics. We always try to keep you, the student, in mind.

Before we indicate to you how we think you can best utilize this *Study Guide* to achieve your goals we want to indicate to you what it contains. Most chapters include the following sections.

### 1. Putting this Chapter into Perspective

In this section we attempt to show you where the particular chapter fits into the big picture and, on occasion, offer you advice about how to study the chapter and on which ideas to concentrate.

### 2. Learning Objectives

Here we list approximately ten things that you should be able to do after you have completed the chapter.

### 3. Chapter Outline

This section presents a sentence outline for the chapter; it provides you with a quick overview of the contents of the chapter and it includes only the most important topics.

### 4. Key Terms

This section provides a list of the most important terms used in the text chapter; these terms are crucial to your understanding and each is defined in the glossary at the end of its *Study Guide* chapter.

### 5. Key Concepts

This is a list of the most important theoretical concepts used in the chapter; these too are explained in the end-of-chapter glossary.



## **6. Completion Questions**

This set of short answer “fill-in-the-blank” questions is intended to test your knowledge of key terms, key concepts, and facts. Some will require an application of the theoretical concepts contained in the text.

## **7. True-False Questions**

This is another objective test to help you see if you understand the main issues in the chapter. We also explain what is wrong with each false statement. We believe that this will be very helpful to you.

## **8. Multiple-Choice Questions**

The numerous multiple-choice questions in each chapter are another objective test to help you decide whether or not you need to spend more time and effort on the chapter at hand.

## **9. Working with Graphs**

Because graphs are so central to the study of economics, we decided to allocate an entire section (in those chapters where applicable) devoted to helping you interpret graphs. We believe that if you can master graphical analysis, the rest of economics will follow easily. The questions appearing in this section are the actual questions that we pose to our students in the classroom; teachers know that if students cannot answer such questions there is no point in moving on.

## **10. Problems**

This section requires you to take a pencil in hand and solve specific problems that depend on your knowledge of the chapter’s contents. Often students believe that they understand certain concepts, but then they cannot solve related problems. By working on these questions you will see the concepts in another light, and a deeper understanding will emerge.

## **11. Case Study**

Here we apply chapter concepts to real life situations, in an attempt to show you how useful and interesting economics can be.

## **12. Answers**

We have placed the answers to the *Study Guide* at the end of each chapter, and not at the end of the book. We believe that you will find this convenient.

## **13. Chapter Glossary**

Because economics vocabulary is so important, we decided to add it to the student guide. And we have placed it where it is the most useful: at the end of the relevant chapter, not at the end of the book.

## HOW TO USE THIS STUDY GUIDE

What follows is a recommended strategy for improving your grade. It may seem like an awful lot of work, but the payoffs will be high. Try the whole program for the first three or four chapters. If you feel you can skip some steps safely, then try doing so and see what happens. After all, only you can know your capabilities and individual circumstances. We do urge you, however, to give this approach a chance.

For each chapter we recommend that you follow the sequence of steps below.

1. Read the introduction, the learning objectives, the sentence outline, and the lists of key terms and concepts in this *Study Guide*; follow any study suggestions offered in the introduction.
2. Read the Chapter Summary in your text at the end of the chapter.
3. Read about half the textbook chapter (unless it is very long), being sure to underline only the most important points which you should be able to recognize after having read two chapter outlines. Put a check mark by that material that you don't understand.
4. If you find the textbook chapter easy to understand, you might want to finish reading it. Otherwise, rest for a sufficient period (you can be the judge of how long it takes you to be refreshed) before you read the second half of the chapter. Again be sure to underline only the most important points and to put a checkmark by the material you find difficult to understand.
5. After you have completed the entire textbook chapter, take a break. Then read only what *you* have underlined, throughout the entire chapter.
6. Now concentrate on the difficult material, by which you have left checkmarks. Reread this material and *think about it*; you will find that it is very exciting to figure out difficult material on your own.
7. Read each of the chapter preview questions in the textbook and write out your answer. After you have finished, compare your answers to the answers to those questions provided by your author at the end of the chapter.
8. Find the comparable chapter in this *Study Guide* and answer the completion questions, the true-false questions, the multiple-choice questions, the problems, and the working with graphs questions. Compare your answers with the answers provided at the back of the *Study Guide* chapter. Make a note of the questions you have missed and find the page(s) in your textbook upon which these *Study Guide* questions are based. If you still don't understand—ask your teacher or your student teaching assistant. (If you decided that our answers are wrong, then by all means write and tell us.)

9. Re-read the learning objectives in this *Study Guide* and decide if you are able to achieve each of these objectives.
10. Before your examination, study your class notes. Reread the *Study Guide* outline, then re-do the completion questions, the true-false questions, the multiple-choice questions, and the problems. Compare your answer with the answer at the back of the appropriate chapter in this guide. Identify your problem areas and re-read the relevant pages in the book. Think through the answers on your own. If you still can't understand the analysis, ask your teacher or your student teaching assistant for help. (Be sure to let your teacher know that you have tried to answer the questions on your own.)

If you have followed the strategy outlined above, you should feel sufficiently confident and be relaxed to do well on your exam.



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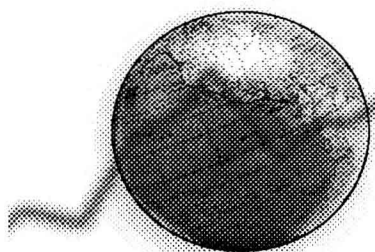
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## CHAPTER 1

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# THE NATURE OF ECONOMICS

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### PUTTING THIS CHAPTER INTO PERSPECTIVE

The aim of Chapter 1 is to help you begin to get a feel for what economics is all about. Chapter 1 defines economics and introduces you to the theory of economic behavior. Economists are concerned with how people do in fact behave in the economic arena *and not* with how people themselves describe their actions, motivations, and beliefs. We contend that people act in ways that promote their own (sometimes broadly-defined) self-interest, and that they respond predictably to economic incentives.

By combining this theory of human behavior with the concept of marginal analysis (analyzed in later chapters) and the "other things constant" assumption, economists are able to (1) generate numerous insights and testable theories about behavior, (2) explain widely disparate social phenomena, and (3) predict how people are likely to behave under numerous circumstances.

Although an understanding of Chapter 1 cannot possibly turn you into an economist, it can certainly begin to give you a feel for "the economic way of thinking." It is a good idea to re-read this chapter every three or four weeks, just to reinforce the important perspective that it provides.

### LEARNING OBJECTIVES

After you have read this chapter you should be able to

1. define economics.
2. distinguish between microeconomics and macroeconomics.
3. recognize the rationality assumption.
4. recognize elements of an economic model, or theory.
5. recognize that economics is ultimately concerned with human behavior.
6. define resource.
7. recognize why young people are more receptive to new ideas and technology than are older people.

8. distinguish between positive economics and normative economics, and be able to classify specific statements under each category.

## CHAPTER OUTLINE

1. Economics, a social science, is defined as the study of how people make choices to satisfy their wants.
  - a. Wants are all the things that people would consume if they had unlimited income.
  - b. Because wants are unlimited and people cannot satisfy all their wants, individuals are forced to make choices about how to spend their income and how to allocate their time.
2. Economics is broadly divided into microeconomics and macroeconomics.
  - a. Microeconomics studies decision making undertaken by individuals (or households) and by firms.
  - b. Macroeconomics studies the behavior of the economy taken as a whole; it deals with such economy-wide phenomena as unemployment, the price level, and national income.
3. Economists assume that individuals are motivated by self-interest and respond predictably to opportunities for gain.
  - a. The rationality assumption is that individuals act *as if* they were rational.
  - b. Self-interest often means a desire for material well-being, but it can also be defined broadly enough to incorporate goals relating to love, friendship, prestige, power, and other human characteristics.
  - c. By assuming that people act in a rational, self-interested way, economists can generate testable theories concerning human behavior.
4. Economics is a Social Science.
  - a. Economists develop models, or theories, which are simplified representations of the real world.
  - b. Such models help economists to understand, explain, and predict economic phenomena in the real world.
  - c. Like other social scientists, economists usually do not perform laboratory experiments; they typically examine what already has occurred in order to test their theories.
  - d. Economic theories, like all scientific theories, are simplifications—and in that sense they are "unrealistic."
  - e. Economists, as do all scientists, employ assumptions; one important economic assumption is "all other things being equal."
  - f. Models or theories are evaluated on their ability to predict, and not on the realism of the assumptions employed.
  - g. Economic models relate to behavior, not thought processes.
5. Economists maintain that the unit of analysis is the individual; members of a group are assumed to pursue their own goals rather than the group's objectives.
6. Positive economics is objective and scientific in nature, and deals with testable *if this, then that* hypotheses.
7. Normative economics is subjective and deals with value judgments, or with what *ought* to be.

**KEY TERMS**

Aggregates  
*Ceteris paribus*  
(other things being equal)  
Economics

Incentives  
Macroeconomics  
Microeconomics  
Models (or theory)

Resource  
Wants

**KEY CONCEPTS**

Normative economics  
Positive economics

Rationality assumption

**COMPLETION QUESTIONS**

Fill in the blank or circle the correct term.

1. Because it is impossible to have all that we want, people are forced to make \_\_\_\_\_.
2. Economics is a (natural, social) science.
3. Economics is the study of how people make \_\_\_\_\_ to satisfy their \_\_\_\_\_.
4. Microeconomics deals with (individual units, the whole economy).
5. A nation's unemployment level is analyzed in (microeconomics, macroeconomics).
6. (Macroeconomics, Microeconomics) studies the causes and effects of inflation.
7. Economists maintain that a member of a group usually attempts to make decisions that are in (her own, the group's) interest.
8. The rationality assumption is that individuals (believe, act as if) they are rational.
9. Economic models are (simplified, realistic) representations of the real world.
10. The *ceteris paribus* assumption enables economists to consider (one thing at a time, everything at once).
11. Younger people are (less, more) likely to try new technology and learn new ideas.
12. Economists maintain that incentives (are, are not) important to decision making.
13. Economists define self-interest (narrowly, broadly).
14. Economists take the (individual, group) as the unit of analysis.
15. Economic statements that are testable and are of an "if/then" nature are (positive, normative).

### TRUE-FALSE QUESTIONS

Circle the **T** if the statement is true, the **F** if it is false. Explain to yourself why a statement is false.

- T F 1. Economics is the study of how people think about economic phenomena.
- T F 2. The economists' definition of self-interest includes only the pursuit of material goods.
- T F 3. Macroeconomics deals with aggregates, or totals, of economic variables.
- T F 4. When economists attempt to predict the number of workers a firm will employ, they are studying macroeconomics.
- T F 5. Economists maintain that people respond in a predictable way to economic incentives.
- T F 6. The rationality assumption is that individuals attempt, quite consciously, to make rational economic decisions, and will admit to it.
- T F 7. It is justifiable to criticize theories on the realism of the assumptions employed.
- T F 8. Households cannot be thought of as producers.
- T F 9. Because economics is a science, economists do not make normative statements.
- T F 10. Love and marriage and decisions regarding the number of children to have are outside the scope of economics.

### MULTIPLE CHOICE QUESTIONS

Circle the letter that corresponds to the best answer.

- 1. Economics is
  - a. a natural science.
  - b. nonscientific.
  - c. a social science.
  - d. usually studied through lab experiments.
- 2. Wants include desires for
  - a. material possessions.
  - b. love.
  - c. power.
  - d. All of the above
- 3. Which of the following areas of study is concerned, primarily, with microeconomics?
  - a. the steel industry
  - b. inflation
  - c. the national unemployment rate
  - d. national income determination
- 4. Macroeconomic analysis deals with
  - a. the steel industry.
  - b. how individuals respond to an increase in the price of gasoline.
  - c. inflation.
  - d. how a change in the price of energy affects a family.



5. Economists maintain that Mr. Smith will usually make decisions that promote the interests of
  - a. his colleagues at work.
  - b. himself.
  - c. his class.
  - d. his race.
6. Economic models
  - a. use unrealistic assumptions.
  - b. are seldom tested in laboratories.
  - c. are concerned with how people behave, not with how they think.
  - d. All of the above
7. An economic model is justifiably criticized if
  - a. its assumptions are not realistic.
  - b. it cannot be tested in a controlled, laboratory experiment.
  - c. it fails to predict.
  - d. All of the above
8. New ideas and new technology
  - a. will not be adopted by older people.
  - b. are adopted less readily by older people, for rational reasons.
  - c. are equally likely to be embraced by people of all ages.
  - d. are ignored only by irrational people.
9. Economics
  - a. is a natural science.
  - b. is concerned with how people respond to incentives.
  - c. is unconcerned with value judgments.
  - d. deals with assumptions, therefore is unrealistic.
10. Concerning Native Americans, in recent years
  - a. economic incentives have increased their (self-reported) numbers.
  - b. their population has fallen dramatically due to high infant mortality rates.
  - c. economic incentives have decreased their numbers.
  - d. their living standards have fallen.
11. Which of the following is a normative economics statement?
  - a. If price rises, people will buy less.
  - b. If price rises, people will buy more.
  - c. If price rises the poor will be injured; therefore price should not be permitted to rise.
  - d. If price rises people will buy less; therefore we ought to observe that quantity demanded falls.
12. Which of the following is a positive economics statement?
  - a. Full employment policies should be pursued.
  - b. If minimum wage rates rise, then unemployment will rise.
  - c. We should take from the rich and give to the poor.
  - d. The government should help the homeless.
13. Normative economics statements
  - a. are testable hypotheses.
  - b. are value-free.
  - c. are subjective, value judgments.
  - d. can be scientifically established.

**MATCHING**

Choose the item in Column (2) that best matches an item in Column (1).

(1)	(2)
a. normative economics	f. nonscientific value judgments
b. macroeconomics	g. objective, scientific hypotheses
c. self-interest	h. study of individual behavior
d. positive economics	i. study of economic aggregates
e. microeconomics	j. rational behavior

**CASE STUDY**

Economists were surprised to discover that most people, when interviewed immediately after purchasing gasoline, did not have any idea what they had just paid per gallon. Non-economists use this as evidence against the notion that people are rational.

Economists maintain that price is an important determinant of consumer behavior, yet, apparently people don't even consider price! How can economists predict consumer behavior if consumers don't even know what price is?

Interestingly, it was discovered that at the *end of the month*, those gasoline stations that charged the highest prices sold the least amount of gasoline, and those that charged the lowest prices sold the most amount of gasoline.

Apparently, although most people didn't know the price per gallon, nevertheless *as a group*, consumers bought more of that gasoline (given quality) that was sold at a cheaper price. Consider this apparent contradiction then answer the following questions.

1. Which consumers are more likely to know the price of gasoline: owners of cab companies and fleets of automobiles, or casual drivers?
2. Is it rational for the typical buyer of gasoline to drive around to every gas station to check price each time she buys—or should she form a buying habit and do business with the same station (and check prices only occasionally)?
3. Why might it be rational for some buyers *knowingly* to pay a higher price and be a regular customer at a higher-priced station? (Hint: consider emergencies).

## ANSWERS TO CHAPTER 1

## COMPLETION QUESTIONS

- |                     |                         |
|---------------------|-------------------------|
| 1. choices          | 9. simplified           |
| 2. social           | 10. one thing at a time |
| 3. choices; wants   | 11. more                |
| 4. individual units | 12. are                 |
| 5. macroeconomics   | 13. broadly             |
| 6. macroeconomics   | 14. individual          |
| 7. her own          | 15. positive            |
| 8. act as if        |                         |

## TRUE AND FALSE QUESTIONS

1. F Economics is the study of how people make choices to satisfy their wants.
2. F Economists have a broader definition of self-interest; wants include power, friendship, love, and so on.
3. T
4. F The example is about microeconomics.
5. T
6. F That assumption is merely that people act *as if* they are rational.
7. F All theories employ unrealistic assumptions; what matters is how well they predict.
8. F Households can be thought of as combining goods and time to produce outputs such as meals.
9. F Economists, like other scientists, can and do make normative statements.
10. F All of these can be subjected to economic analysis.

## MULTIPLE CHOICE QUESTIONS

- 1.c; 2.d; 3.a; 4.c; 5.b; 6.d; 7.c; 8.b; 9.b; 10.a;  
11.c; 12.b; 13.c.

## MATCHING

a and f; b and i; c and j; d and g; e and h

## CASE STUDY

1. People who spend *a lot* of funds on gasoline are more likely to know its price, not casual drivers.
2. It is rational to form habits and to check price only occasionally, because people value their time too.
3. You might knowingly trade with a higher-priced gasoline station because you can get to know and trust the owner who can then be relied upon to fix or tow your car in an emergency—at a reasonable price.

## GLOSSARY TO CHAPTER 1

**Aggregates** Total amounts or quantities; aggregate demand, for example, relates to the total demand within a nation.

***Ceteris paribus* assumption** The assumption that all things are held equal, or constant, except those under study.