
Chapter Overview

The chapter begins with material about economics in general, almost immediately introducing the student to tradeoffs that must be weighed in making choices (for example, costs and benefits). Important economic terminology is introduced and defined (such as scarcity), and the nature and methodology of economics are presented. Seven key principles of economics are introduced and discussed.

Chapter Outline

What Is Economics About?

- Why Should One Study Economics?

- Microeconomics Versus Macroeconomics

- Economic Theories and Reality

 - Model Building

 - Ceteris Paribus*: All Else Held Constant

- Issue*: Have Smart Phones and Social Media Made Life Easier?

- Efficiency Versus Equity

- Positive Versus Normative Questions

- Checkpoint*: What Is Economics About?

Key Principles of Economics

- Principle 1: Economics Is Concerned with Making Choices with Limited Resources

- Principle 2: When Making Decisions, One Must Take Into Account Tradeoffs and Opportunity Costs

- Principle 3: Specialization Leads to Gains for All Involved

- Principle 4: People Respond to Incentives, Both Good and Bad

- Principle 5: Rational Behavior Requires Thinking on the Margin

- Principle 6: Markets Are Generally Efficient, But They Are Not Perfect

- Principle 7: Institutions and Human Creativity Help Explain the Wealth of Nations

- Summing It All Up: Economics Is All Around Us

Issue: Do Economists Ever Agree on Anything?

Checkpoint: Key Principles of Economics

Appendix: Working With Graphs and Formulas

Ideas for Capturing Your Classroom Audience

- Talk about choices. Using either small groups or the class as a whole, develop a list of choices students have made, including their choice to take your class! Keep the list available for reference when you discuss the key principles of economics detailed in this chapter. Discuss similarities and differences to illustrate how economics can account for the individual and the collection of individual choices. You may also want to consider a follow-up assignment in which students are asked to relate the key principles to the choices they make every day, with particular emphasis on developing a consciousness of opportunity cost and thinking on the margin.
- Bring the global economy into your classroom. Ask students where many of the goods they use were made. The example of iPods can be used to illustrate a business decision about where to produce a product (in this case, China) based on cost. This also allows for a discussion of globalization, outsourcing, and issues of worker exploitation. Have students use a search engine such as Google and use the key words “iPods where made.” A number of sources will pop up, including the article at <http://www.scribd.com/doc/969788/Why-iPods-Are-Made-in-China> that clearly explains the cost advantages and trade aspects. Other articles of interest include those that explore what a “fair trade” iPod would cost.

Chapter Checkpoints

What Is Economics About?

Question: Determine whether each issue below is a microeconomic or macroeconomic issue.

1. Hewlett-Packard announces that it is lowering the price of its printers by 15%.
2. The president proposes a tax cut.
3. You decide to look for a new job.
4. The economy is in a recession, and the job market is bad.
5. The Federal Reserve announces that it is raising interest rates because it fears inflation.
6. You get a nice raise.
7. Average wages grew by 2% last year.

The point is to check that students can: determine whether the issue deals with an individual, firm, or industry (and how they make decisions), and thus is a MICRO issue, or whether it focuses on broader economic issues, such as inflation, employment and unemployment, and economic growth, and thus is a MACRO issue.

For the MICRO issues (1, 3, 6): Emphasize the “you” (meaning the individual) in issues 3 and 6, and the individual company noted in issue 1.

For the MACRO issues (2, 4, 5, 7): Students may identify the terms “recession” and “inflation” in issues 4 and 5, but the macro aspects of a “tax cut” and “average wages” in issues 2 and 7 may not be as obvious.

The “couplets” of answers 3 and 4 and 6 and 7 provide good opportunities to point at the relationship and differences between macro and micro.

Key Principles of Economics

Question: McDonald’s has recently introduced a premium blend of coffee that sells for more than its standard coffee. How does this represent thinking on the margin?

The point is to check that students can: apply the idea of thinking on the margin to a real-world business decision. Students will likely identify that this is an attempt by McDonald’s to compete with Starbucks and Dunkin’ Donuts (and any other coffee sellers in the area of their stores). The emphasis here is that firms use marginal concepts in making decisions: What is the marginal revenue from one more product or even one more cup of coffee sold? What is the marginal cost? Students may identify that once the equipment is installed the additional costs of brewing more cups depends only on the ingredients used.

Debate the Issues

Issue: Have Smart Phones and Social Media Made Life Easier?

The key message in this segment is that “Each individual is unique and weighs the benefits and costs of technology differently. How you value these benefits and costs will ultimately determine how you choose to adapt to new and existing technologies. Economics involves all sorts of decisions, including how well connected we choose to be in life.”

Use this to reinforce student understanding of costs and benefits and how individualized that analysis really is. Could one person’s cost be seen by someone else as a benefit? This also raises issues about the value of time and information that will come up later in the text.

Issue: Do Economists Ever Agree on Anything?

Visit the Web site of the IGM Economics Experts Panel at <http://www.igmchicago.org/igm-economic-experts-panel>. Note that the Web site describes the panel as follows: “To that end, our panel was chosen to include distinguished experts with a keen interest in public policy from the major areas of economics, to be geographically diverse, and to include Democrats, Republicans and Independents as well as older and younger scholars.”

This is a good opportunity to point out the difference between “positive” and “normative” questions. Economists from different geographic areas or with differing political beliefs may disagree on policy issues and solutions, because their ideas of what “ought” to be are fundamentally different. It is worth noting, however, that even those things that students would believe are “positive” (facts!) are not so easily agreed upon either. For example, how many people are unemployed?

Examples Used in the End-of-Chapter Questions

Questions 2, 5, 12, and 13 reference the choices of going to college and of majoring in economics, out of all the possible degrees. In recent years this question has gained an added aspect of the debt college students accumulate by the time they graduate. Use this for a short research paper that encourages students to apply the key principles of economics discussed in the chapter to the choices of college and undergraduate major. The costs should now include the cost of the debt repayment after graduation.

Students can easily find information about jobs and salaries at the Web sites for the Bureau of Labor Statistics (<http://www.bls.gov/ooh/Life-Physical-and-Social-Science/Economists.htm>), Education Portal (http://education-portal.com/articles/Salary_of_an_Economics_Major_How_Much_Do_Graduates_Earn.html), and *Forbes* (<http://www.forbes.com/2010/08/11/college-degrees-best-salaries-leadership-careers-jobs.html>). There are many other current articles from a variety of sources that can be found by searching with the phrase “college student debt.” Students may also find it valuable to visit the Web site of the Project on Student Debt at http://projectonstudentdebt.org/state_by_state-data.php. If you wish to make this research more extensive, asks students to investigate the sources for any “normative” aspects.

Questions 2 and 13 reference the value of an Economics degree. See a 2005 story from the *Wall Street Journal* reporting a “clear explosion in economics as a major.” (Jessica E. Vascellaro, “The Hot Major for Undergrads Is Economics,” the *Wall Street Journal*, July 5, 2005, p. A11). This question asks students to consider why this might be the case. Students should be encouraged to apply the key principles of economics discussed in the chapter to the choice of undergraduate major. In the online version of the story the title includes the important point that economics is the hot major for students seeking higher pay. (The story is available at <http://online.wsj.com/article/0,,SB112052978616277054,00.html>.)

Economics Is Everywhere

The following short synopsis, selected from the many vignettes in *Economics Is Everywhere* by Daniel S. Hamermesh (packaged for free with any Worth Principles text), corresponds to the material covered in this chapter of the text. The question that accompanies each vignette appears as an essay-type question in the Hamermesh text; for use with the Chiang text, those questions are adapted to a multiple-choice format and are also assignable in LaunchPad. The correct answers are indicated and feedback is provided here.

1.15 At a party on a university’s campus, “free” Ben & Jerry’s ice cream was being distributed. However, as one might expect, there was a line to get it. The point of the vignette is to make students aware that the use of time is a cost (opportunity cost) and that the cost will differ for different people.

Q: The line to get “free” Ben & Jerry’s ice cream has about 20 people already in it and seems to be moving slowly. Which of the following statements is correct?

- a. Since the ice cream is free, there is no cost attached to obtaining ice cream.
- b. Professors and students are equally likely to wait in line to get ice cream.

- c. Professors would be less likely than students to wait in line to get ice cream.
- d. Professors would be more likely than students to wait in line to get ice cream.

A. Correct: c. There is a cost to getting the ice cream even though it has no price in money. The cost is time, and this raises the issue of opportunity cost. It is likely that professors have a higher opportunity cost of time than students and thus are less likely to want to spend their time waiting in a line.

1.24 Designers of new public buildings appear to be making an attempt to allocate more bathroom space to women than to men so as to equalize waiting times. If the opportunity cost of a woman's time is less than that of a man, one could argue from an economic point of view that it would not be inefficient for women to wait longer.

Q: Considering the question of efficiency rather than equity, which of the following would you be likely to observe?

- a. People who live in countries that are less wealthy than the United States are likely to wait longer to use a bathroom.
- b. People who live in countries that are less wealthy than the United States are not likely to wait longer to use a bathroom.
- c. People who live in countries that are less wealthy than the United States are likely to wait about the same time to use a bathroom as people would in the United States.
- d. There are no obvious differences by gender in countries less wealthy than the United States.

A: Correct: a. Assuming that the opportunity cost of time is lower for people in less wealthy countries, the efficiency argument is that people would be willing to wait longer.

For Further Analysis

A First Look at Issues in Environmental Policy

Handout 1-1 can be used as an in-class group exercise or as an individual assignment. Asking students to document research allows you to use this as a case study or group project.

Learning objectives: application of five of the seven key principles of economics to a specific policy issue and reinforcement of critical thinking skills.

The key principles addressed in the example are:

- Economics Is Concerned with Making Choices with Limited Resources
- When Making Decisions, One Must Take Into Account Tradeoffs and Opportunity Costs
- Rational Behavior Requires Thinking on the Margin
- People Respond to Incentives, Both Good and Bad
- Markets Are Generally Efficient, But They Are Not Perfect

Begin your presentation using the handout with an overview of pollution, specifically air pollution. Brainstorm with students to ascertain the knowledge base and then ask them to consider the following questions:

- 1) Should the goal be zero air pollution?
- 2) What is the most efficient way to achieve reduced pollution?

Remind students of the key principles of economics listed above. The discussion/ responses should elicit the following (among other points):

- a) There are costs as well as benefits to reducing pollution. If you want to, express this intuitively in terms of marginal cost and marginal benefit.
- b) The cost of reducing pollution represents funds NOT spent on other programs, and so forth.
- c) Pollution is an illustration of market failure. (You may wish to reference externalities.)
- d) Governments can deal with pollution through regulation, or use market-based incentives (pollution permits).

Follow-up Assignment

Have students research cap and trade. The U.S. Environmental Protection Agency provides a good overview on its Web site at <http://www.epa.gov/capandtrade/>. Students can also find news stories for and against such programs. Integrate this with the discussion of a legislative approach and a market approach. Students can critically evaluate the pros and cons of each approach. Be sure that students include an evaluation of regulations versus market incentives, and the benefits and costs involved.

Web-based Exercise

Students can investigate available data about air pollution (and how it is presented in charts and graphs) by visiting the Environmental Protection Agency's Web site at <http://www.epa.gov/region09/air/trends/index.html>. Note: Students can search by regions, which reinforces the idea introduced earlier that people from different geographic areas have different perspectives on issues.

Two More Key Principles of Economics

In Handout 1-2 students are asked to apply the two remaining key principles discussed in this chapter. For each key principle a topic for student discussion and reflection is provided, as are suggestions about how to develop the analysis.

This example can be used as an in-class group exercise or as an individual assignment. Asking students to document research allows you to use this as a case study or group project as well.

Learning objectives: application of two of the seven key principles of economics and reinforcement of critical thinking skills.

The key principles addressed are:

- Specialization Leads to Gains for All Involved
- Institutions and Human Creativity Help Explain the Wealth of Nations

Questions for discussion/reflection:

- 1) What is outsourcing? How is this related to specialization?
- 2) Why do so many items seem to be "made in China"?
- 3) What factors can increase worker productivity?

For more information:

- 1) The Nobel Prize Web site features a number of educational games, including one on international trade. The site also provides a good overview of trade theory (http://nobelprize.org/educational_games/economics/trade/ohlin.html).
- 2) Students can learn more about U.S. productivity statistics on the Web site of the Bureau of Labor Statistics at <http://www.bls.gov/bls/productivity.htm>.

Tips from a Colleague

Don't be reluctant to mention concepts or definitions early on in the course even if you know you'll be covering them in more detail later. The more connections you can make between this introductory material and students' knowledge and/or interests the better.

HANDOUT 1 - 1

Date_____ Name_____ Class_____ Professor_____

A First Look at Issues in Environmental Policy

Briefly explain each of the following:

Economics Is Concerned with Making Choices with Limited Resources

When Making Decisions, One Must Take into Account Tradeoffs and Opportunity Costs

Rational Behavior Requires Thinking on the Margin

People Respond to Incentives, Both Good and Bad

Markets Are Generally Efficient, But They Are Not Perfect

Consider the issue of air pollution. From the point of view of a society:

1) Should the goal be zero air pollution?

2) What is the most efficient way to achieve reduced pollution?

HANDOUT 1-2

Date_____ Name_____ Class_____ Professor_____

Two More Key Principles of Economics

Briefly explain each of the following:

Specialization Leads to Gains for All Involved

Institutions and Human Creativity Help Explain the Wealth of Nations

Reflect on/discuss each of the following questions and relate them to the key principles you defined above:

1) What is outsourcing? How is such trading related to specialization?

2) Why do so many items seem to be “made in China”?

3) What factors can increase worker productivity?

ANSWERS TO HANDOUT 1-1

A First Look at Issues in Environmental Policy

Briefly explain each of the following:

Economics Is Concerned with Making Choices with Limited Resources

Resources are limited; therefore we face scarcity. As a result of scarcity we must make choices or tradeoffs.

When Making Decisions, One Must Take Into Account Tradeoffs and Opportunity Costs

If we undertake one activity, some other highly valued activity must be given up. Every activity we do involves opportunity costs.

Rational Behavior Requires Thinking on the Margin

Rational behavior means making choices that are beneficial. Thinking on the margin means asking "should I have one more?" of something.

People Respond to Incentives, Both Good and Bad

If people are rational, they will respond to changes that provide additional benefits. For example, if travel during an off-peak time is less expensive, people with flexible schedules will find it in their interests to take advantage of the lower fare.

Markets Are Generally Efficient, But They Are Not Perfect

Private markets and the incentives they provide are the best mechanisms for providing goods and services. When markets fail, government can help to achieve a more efficient outcome for society.

Consider the issue of air pollution. From the point of view of a society:

1) Should the goal be zero air pollution?

No. As desirable as it seems to keep reducing pollution, doing so comes at a cost. Remember, each activity has an opportunity cost, and so money spent on pollution reduction cannot be spent on some other socially desirable activity. An economist would say that pollution should be reduced to the point where the added (marginal) benefit from reducing pollution is equal to the added (marginal) cost.

2) What is the most efficient way to achieve reduced pollution?

Recent experience suggests that a market mechanism can be more efficient than government regulations in reducing pollution. Under this system the government creates "permits" that allow firms to emit set amounts of pollutants. Firms who have more permits than they need can sell them to other firms who need more. By setting the number of permits, the government controls the total amount of pollutants released and, by allowing firms to buy and sell the permits, those firms that reduce pollution gain at the expense of those who are heavier polluters. As permits become more expensive this system should provide an incentive for firms to invest in pollution-reducing equipment.

ANSWERS TO HANDOUT 1-2

Two More Key Principles of Economics

Briefly explain each of the following:

Specialization Leads to Gains for All Involved

Specialization means that each product (at least in theory) would be produced by its most efficient producer. Producers would then trade with one another to obtain all the goods and services they desire. By this process all resources would be used most efficiently.

Institutions and Human Creativity Help Explain the Wealth of Nations

Institutions and human creativity foster increased productivity. Higher productivity results in higher average per capita income and therefore higher standards of living.

Reflect on/discuss each of the following questions and relate them to the principles you defined above:

1) What is outsourcing? How is such trading related to specialization?

Outsourcing is when production is shifted “outside” a firm or nation. The production is shifted to the producer that has the lowest cost or that specializes in that product.

2) Why do so many items seem to be “made in China”?

China has become a major producer of many items, including many types of clothing. This is a result of specialization, meaning that China can be an efficient and low-cost producer of such items because of its large work force and relatively lower wages.

3) What factors can increase worker productivity?

Worker productivity can be increased by education and training and by providing workers with better tools with which to produce.