

## **Part I: Ten Key Elements of Economics**



### **Element 1: Incentives Matter.**

1. What is the basic postulate of economics? Why is this a powerful tool that enhances our understanding of human behavior?
2. Why do the authors raise the question of whether incentives would matter if people were altruistic -- that is, if people were not "greedy and selfish". How do incentives matter even in cases of altruism and/or charity? Explain, using examples other than those used by the authors (i.e., drowning children and Mother Theresa).
3. How do incentives influence the choices of political participants- as voters and/or elected officials? What are some examples you can think of to illustrate this point?
4. Suppose you are taking a class and the teacher announces that all students will receive the same grade at the end of the term. How would this influence a students' incentive to study and master the material? If teachers want their students to learn the course material, do they have a strong incentive to establish a close relationship between performance and the grade earned? Explain.
5. Which of the following statements support the claim that incentives matter?
  - a. When income transfers to the able-bodied poor increase, the recipients will have less incentive to work.
  - b. An increase in the fines associated with downloading music and videos protected by copyright laws reduces the number of people engaging in this activity.
  - c. An increase in the number of people downloading music and videos negatively impacts the commercial production of music and videos.
  - d. All of the above

### **Element 2: There Is No Such Thing as a Free Lunch.**

6. Why do individuals have a strong incentive to attempt to get the most out of the resources that they own? When you go to the mall, do you try to get the most value from your consumer spending? Why or why not?
7. What does the cost of a good or service reflect? At what point will profit-maximizing producers no longer have incentive to supply a good or service to consumers?
8. Can the government provide goods and services such as housing, education, or health care “free” to its citizens? If so, how does this affect the incentive of people to consume these public goods and services? Explain, using examples.

### **Element 3: Decisions Are Made at the Margin.**

9. What does it mean to make a decision “at the margin”? Ask students to provide examples of how they used marginal analysis to decide whether to attend class one day this week.
10. Why do economists pay so much attention to marginal benefits and marginal costs? Hint: when making decisions, do we consider the marginal benefits and costs or the total benefits and costs?
11. Use the example of pollution control in the text to explain how political decisions can (and should!) also be subject to marginal analysis. Provide another example from your own experience of a policy decision that did **not** seem to have been analyzed at the margin.
12. “People commonly ignore the implications of marginalism in their comments and votes but seldom in their personal actions.” What do you think the authors mean by this statement? Do you agree or disagree, and why? Use examples, other than those from the text, to support your answer.
13. Why is the price of diamonds so much greater than the price of water? Does marginal analysis help provide the answer?
14. Which of the following statements best describes the motivations behind most business behaviors?
  - a. Selfish desires motivate business people and, therefore, personal benefits and costs are ignored.
  - b. Humanitarian or spiritual concerns seldom influence business decisions and, therefore, personal benefits and costs are ignored.

- c. Business people are motivated by a variety of social, economic, political, spiritual and cultural forces; personal and business benefits and costs are taken into account.
- d. Business people are motivated solely by improving their financial status.

**Element 4: Trade Promotes Economic Progress.**

- 15. Why do people trade?
- 16. What is the law of comparative advantage? Why does it lead to specialization, and how does this improve living standards?
- 17. Explain the law of comparative advantage and the principle of economies of scale in your own words. Explain how each one of these fundamental ideas help trading partners produce larger quantities of output than would otherwise be attainable.
- 18. How do trade restrictions influence economic welfare? Does trade between parties in different countries work differently than domestic trade?

**Element 5: Transactions Costs Are an Obstacle to Trade.**

- 19. What are transactions costs? How do “middlemen” influence transactions costs? Do middlemen add value to trade, or do they merely add to the cost of obtaining the good?
- 20. Would the individual states of the United States be better off if a 10% tax was levied on all goods “imported” from another state? Which group(s) would support such a policy? Oppose it? Why? How would such a policy impact unemployment rates in the individual states?

**Element 6: Profits Direct Businesses Toward Activities That Increase Wealth.**

- 21. If we want to get the most out of our resources, do we want activities that are undertaken to be profitable? Why or why not?
- 22. Evaluate the statement: “Production should be for people and not for profit.” Think about the following in formulating your answer:
  - a. If production is profitable, are consumers helped or hurt?
  - b. Would consumers be helped more if production resulted in a loss?
  - c. To what extent is there a conflict between the producers’ incentives and the welfare of consumers?

23. The text suggests that “even though business failures are often painful for the investors and employees involved, there is a positive side.” What is it? Why do many economists stress that losses may be even more important than profits?

**Element 7: People Earn Income by Helping Others.**

24. Do you agree or disagree with the following quote: “...if you want to earn a large income, you had better figure out how to help others a great deal. The opposite is also true. If you are unable and unwilling to help others, your income will be small.” Does “doing good” always translate into “doing well”? How can this statement still be true, even in the face of seemingly contradictory examples, like public school teachers and nurses?
25. If an individual is motivated primarily by the desire to make money, will he or she have an incentive to be helpful to others? Will he or she have an incentive to develop skills that others value highly? Why or why not?
26. Explain why investment in education or specialization in learning how to help others increases earning power.

**Element 8: Economic Progress Comes Primarily Through Trade, Investment, Better Ways of Doing Things, and Sound Economic Institutions.**

27. What are the primary sources of high per capita income? Why are the incomes of Americans so much higher today than 100 years ago?
28. Describe the role of the entrepreneur in a market economy. What must an individual do in order to undertake an entrepreneurial venture? Why is the role of the entrepreneur an important source of economic progress?
29. Do the legal institutions of a country matter? What are some of the characteristics of legal institutions that would help promote economic progress?

**Element 9: The “Invisible Hand” of Market Prices Directs Buyers and Sellers Toward Activities That Promote the General Welfare.**

30. How can you explain that the quantities of milk, bananas, candy bars, television sets, notebook paper and thousands of other items available in your hometown are approximately equal to the quantities local consumers want to buy?

31. In a market economy, will there be a tendency for both resources and products to be supplied by low-cost producers? Why or why not? Does this matter? Explain.
32. Suppose that enrollment at your college increases sharply and as a result there is a substantial increase in the number of students looking for apartments. How will this affect the price of apartments in the area? How will this change influence the incentive to conserve on the use of apartment space? If markets are allowed to operate, how will the increase in demand for student apartments impact the future supply? Explain.
33. What is “self-interest”? Is self-interest the same thing as selfishness and greed? Explain.
34. In a market economy, when individuals pursue their own self-interest, how will their actions influence the well-being of others?

**Element 10: Too Often Long-term Consequences, or the Secondary Effects, of an Action Are Ignored.**

35. Do increases in government expenditures create jobs? Why or why not?
36. Explain the meaning of the following quote: “Especially in politics there is a tendency to stress the short-term benefits of a policy while ignoring its long-term consequences.” Can this tendency be avoided? Discuss.
37. Can politicians deliberately ignore the secondary effect(s) of a policy? Explain. What are some examples of instances where this has (or at least could have) happened?
38. Explain how the decisions of today have consequences that lie in the future.