

Part I: Ten Key Elements of Economics



Element 1: Incentives Matter.

1. What are incentives, and how do they influence behavior? Why do the authors say that, “All of economics rests on (this) one simple principle”?
2. Describe the following statement in your own words: “Your behavior when shopping in the mall is similar to the behavior of the person ‘shopping’ in the voting booth.”
3. Describe how your study habits would likely change if the grading system shifted from a letter grading system to a satisfactory/unsatisfactory grading system.
4. 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.

5. 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?
6. If a good or service is provided free of charge, how will this affect your incentive to conserve on its use?
7. Explain why there is no such thing as a free lunch or even a free ring tone?

Element 3: Decisions Are Made at the Margin.

8. What does it mean to make a decision “at the margin”? Provide an example of how you used marginal analysis to decide whether to attend class one day this week.
9. A restaurant offers an “all you can eat” lunch buffet for \$10. You have already eaten two servings, and are now trying to decide whether to go back for a third. Describe how you can use marginal analysis to decide.
10. The owner of a convenience store decides to keep one employee on the payroll from 9.00 to 10.00 pm. The employee is paid a wage rate of \$6.00 an hour, and the store expects to earn an additional \$20 from the sales of food and sundry items. Use economic reasoning to explain why it makes sense to hire the worker and stay open for the additional hour.
11. Which of the following statements best describes the motivation behind most of your behaviors?
 - a. Selfish desires motivate you and, therefore, personal benefits and costs are ignored.
 - b. Humanitarian or spiritual concerns mostly drive your decisions and, therefore, personal benefits and costs are ignored.
 - c. You are motivated by a variety of social, economic, political, spiritual and cultural forces; personal benefits and costs are never taken into account.
 - d. You are motivated by a variety of social, economic, political, spiritual and cultural forces; personal benefits and costs matter.

Element 4: Trade Promotes Economic Progress.

12. Why do people trade?
13. Explain how trade increases the value obtained from goods and services even though nothing new is produced. What does “wealth” mean in this context?
14. What is the law of comparative advantage? Why does it lead to specialization, and how does this improve living standards?
15. Why do you buy many goods and services from others rather than producing them yourself? Would Americans, in general, be better off if we were self-sufficient and produced everything we consumed rather than traded with people abroad?

16. What are economies of scale? Why will large scale producers often be able to supply you with a good at a substantially lower cost than either you or the local mom-and-pop business could produce it? What role do economies of scale play in increasing the gains from trade that could not be achieved simply through self-sufficiency or small scale production?
17. Individuals in a barter economy voluntarily exchange goods and services for other goods and services. Compared to an economy with money, the volume of trade in the barter economy will be
- the same
 - higher
 - lower

Element 5: Transactions Costs Are an Obstacle to Trade.

18. What are transactions costs? How do they impede trade?
19. "Countries that impose obstacles to exchange – either domestic or international – reduce the ability of their citizens to achieve more prosperous lives." Indicate why you either agree or disagree with this statement.
20. How have the following influenced the volume of trade?
- the internet
 - the interstate highway system
 - tariffs on goods and services imported from foreign producers

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

21. What must a firm do in order to make a profit?
22. What is the function of profits in a market economy?
23. If we want to get the most out of our resources, is the role of losses just as important as that of profits? Why or why not?
24. Which of the following statements *best* describes the motivation behind local business behaviors when a sole proprietorship or partnership in your community realizes a high profit by offering a new service?
- There will be an increase in the number of businesses offering a similar service.
 - Business competitors will not be impacted.
 - The price of the new service will fall as more businesses enter the market and offer similar services.

Element 7: People Earn Income by Helping Others.

25. Will hard work guarantee a substantial income? Why or why not?
26. Explain the fallacious reasoning in the following phrase: “high-income individuals must be exploiting others”.
27. Explain why earning power is positively impacted by increased investment in education or specialization in learning how to help others.

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

28. Explain how each of the following promote economic progress.
 - a. investments in productive assets
 - b. advancements in technology
 - c. improvements in economic organization
 - d. entrepreneurship
29. “Our modern living standards are primarily a reflection of brain power, capital formation, and the quality of institutions.” What is the meaning of this statement? Is it true?

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

30. Describe Adam Smith’s “invisible hand” principle. How does self-interest actually work to help others (even when the consequences are unintended)?
31. How do consumers decide whether to purchase a product? In other words, identify the incentives behind buying certain products and rejecting others. Are consumers, on average, forced to purchase certain products or quantities of goods and services? Why or why not?
32. How do producers decide whether to produce a good or service? Are they forced? Identify the incentives behind producing certain items and not producing others. Are producers, on average, forced to produce certain items? Why or why not?
33. What coordinates the actions and interactions of consumers and producers in a competitive market system? What brings them into harmony?

34. Suppose you enjoy a pizza and soda at a local restaurant, and then go to a movie. How many people do you think contributed to your enjoyment of these activities? What motivated them to do so?
35. How did Friedrich von Hayek explain the information distribution function of markets? What information is conveyed via markets, and how?

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

36. What are secondary effects? Give several examples of secondary effects in your personal lives.
37. Why does failure to consider the secondary effects often result in fallacious economic reasoning?
38. In 2002, the Bush administration imposed steel import quotas that limited the entry of foreign-produced steel into the U.S. market. What were some of the secondary effects of this policy? Did the policy expand employment as the administration argued that it would?
39. Give some examples of the secondary effects that can arise as a result of the influence of interest groups.
40. Explain how the decisions of today have consequences that lie in the future.
41. Which of the following item(s) identify the positive secondary effect(s) of encouraging U.S. imports?
- a. The total employment level in the U.S. declines.
 - b. The price paid by U.S. consumers in markets affected by the imports decreases.
 - c. Improvement in the U.S. standard of living is realized.