

ECON 1000 – Contemporary Economic Issues Study Guide
“Foundations of Economics”

Relevant Readings from the Required Textbook:

- Chapter 1, *Foundations of Economics*

Definitions and Concepts:

- **economics** – the social science that studies how people make decisions in the face of scarcity and the resulting impact of such decisions on both society as a whole and the individual members therein.
- **scarcity** – a universal phenomenon that arises because resources are limited.
- **tradeoffs** – the recognition that in many situations acquiring more of one thing can often only be done at the expense of getting by with less of something else.
- **microeconomics** – the study of how individual decision maker behave and interact with each other, often with a focus on how households and firms behave and interact with each other in markets.
- **macroeconomics** – the study of the functioning and performance of a society’s economy as a whole, often with a focus on levels of and changes in aggregate measures such as the inflation rate, unemployment rate, and gross domestic product growth rate
- **positive statement** – a statement that aims to describe how the world actually is or actually functions.
- **normative statement** – a statement that aims to assess the desirability of how the world is or functions, perhaps with suggestions of things that could be done to improve matters.
- **“Views of Economists on Economic and Public Policy Issues”**
(Table 1.1 on Page 6 of textbook)
- **rational decision maker** – someone with a well-defined goal, who takes actions to achieve the goal as best as possible.
- **total benefits** – the gains that a person realizes from taking an action.
- **total costs** – the burdens that a person incurs from taking an action.

- **total economic surplus** – the difference between total benefits and total costs.
- **Cost-Benefit Principle** – a guide to decision-making which states that an individual should undertake an activity if and only if the additional benefit of doing so is greater than or equal to the additional cost of doing so.
- **marginal benefit** – the change in the value of total benefits as more of an activity is undertaken.
- **marginal cost** – the change in the value of total costs as more of an activity is undertaken.
- **Incentive Principle** – a summary of how behavior of a rational decision maker will change as costs or benefits change: (i) if the marginal benefit of an activity increases, then a rational person will engage in more of the activity, whereas (ii) if the marginal cost of an activity increases, then a rational person will engage in less of the activity.
 - **self-interested individual** – someone who makes his own personal assessment of the benefits and costs associated with different outcomes, and who subsequently uses these measures as the basis for decision making.

Multiple Choice Questions:

1. The Incentive Principle states that
 - A. a society can produce a greater amount of total output when individuals focus their production on those activities for which they have a comparative advantage.
 - B. having more of one thing usually means getting by with less of something else.
 - C. an action should be taken if and only if the additional benefits from taking the action are at least as great as the additional costs of doing so.
 - D. if the marginal benefit of an activity increases, then a rational person will engage in more of the activity.

2. In 2015 High School graduates earned \$11,037 per year more than non-High School graduates. If this difference had instead been \$8,500 per year, then we would expect
 - A. more people to drop out of school before graduating High School.
 - B. fewer people to drop out of school before graduating High School.
 - C. that nobody would change their behavior.
 - D. more children to start eating breakfast at school.

3. Economics is
 - A. the social science that studies human mental functions and behavior, with a focus on phenomena such as perception, cognition, personality, and interpersonal relationships.
 - B. the social science that studies decision making in the face of scarcity and the resulting impact of such decisions on both society as a whole and on the individual members therein
 - C. the social science that studies the allocation and transfer of power in decision-making, systems of governance, and the effects of public policy.
 - D. the art of communicating financial information about a business entity to stakeholders, such as employees, managers, shareholders, and customers.

4. In July 2012 professional golfer Adam Scott bogeyed the last four holes of the British Open to lose the tournament to Ernie Els by one stroke. Around the same time flooding in Beijing, China resulted in the death of at least 77 people. If Adam was more upset about the outcome of the British Open than about the loss of life from the flooding in Beijing, then it would seemingly suggest that he
 - A. is not as good of a person as Ernie Els.
 - B. does not care about anyone other than himself.
 - C. is an irrational individual.
 - D. is a self-interested individual.

5. Alex recently saw the comedian Ron White perform at the Topeka Performing Arts Center in Topeka, KS. His Total Benefits from seeing this show were \$120, while his Total Costs were \$70. From this information, it follows that his Economic Surplus
 - A. from attending the show was $(\$120) - (\$70) = (\$50)$.
 - B. from attending the show was $(\$70) - (\$120) = (\$-50)$ (i.e., negative \$50).

- C. from attending the show was $(\$70) + (\$120) = (\$190)$.
- D. would have been greater if he had instead spent the \$120 on Ron White DVDs.

6. Normative Statements

- A. attempt to describe how the world actually is or actually functions.
- B. are scientific in nature, in that given enough research, evidence, and data, they can potentially be shown to be either true or false.
- C. are supported (either implicitly or explicitly) by the priorities, goals, and value judgments of the person making the statement.
- D. More than one (perhaps all) of the above answers is correct.

7. A “Rational Decision Maker” should

- A. always take every action for which there is a positive Marginal Benefit.
- B. never take any action for which there is a positive Marginal Cost.
- C. take an action if and only if the Marginal Benefit of the action is at least as great as the Marginal Cost of the action.
- D. More than one (perhaps all) of the above answers is correct.

8. The quote on page 17 of the course textbook suggests that Milton Friedman believed that Mother Theresa was

- A. rational and self-interested.
- B. rational but not self-interested.
- C. irrational and not self-interested.
- D. irrational but self-interested.

9. Which of the following statements is a “Positive Statement”?

- A. Elvis Presley died on August 16, 1977.
- B. The possession and use of all “recreational drugs” should be legal.
- C. Our country would be a better place to live if we decreased spending on national defense and increased spending on healthcare for low income families.
- D. More than one (perhaps all) of the above answers is correct.

10. Armen Alchain and Gordon Tullock

- A. wrote a letter to FDR in 1939, advising him to have the U.S. government assist physicists in the U.S. working on research related to the creation of a uranium bomb.

- B. were the first to recognize that increasing the minimum wage would decrease the unemployment rate of young and unskilled workers.
 - C. argued that automobile accident rates could be decreased by installing “five point harness” seat belts and improved airbags in every car.
 - D. argued that automobile accident rates could be decreased by installing a sharp, irremovable, foot long, iron spike to the steering wheel of every car.
11. Paula enjoys going to the movies. In July she saw 8 movies in the theatre. Her Marginal Benefit of the 8th movie was \$16, while her Marginal Cost of the 8th movie was \$12. Based upon this information alone, her Economic Surplus
- A. would have been smaller if she had instead gone to the movies 7 times.
 - B. would have been larger if she had instead gone to the movies 7 times.
 - C. was clearly maximized by going to the movies exactly 8 times.
 - D. would have been larger if she had instead gone to the movies 9 times.
12. is the branch of economics which studies how individual decision- makers behave and interact with each other, often with a focus on how households and firms behave and interact with each other in markets.
- A. Macroeconomics
 - B. Microeconomics
 - C. Comparative Economic Systems
 - D. Political Science
13. A “Self-Interested” person
- A. does not care about the well-being of anyone (including himself).
 - B. cares only about his own well-being (and does not care at all about the well-being of others).
 - C. cares about his own well-being more than the well-being of others.
 - D. cares about the well-being of others more than his own well-being.
14. When considering potential government policies, it is important to recognize that
- A. most businesses are not run by “rational decision makers.”
 - B. voluntary trade generally makes sellers better off but buyers worse off.
 - C. if a policy alters the costs and/or benefits for a decision maker, then the decision maker might change his behavior as a result of the policy.
 - D. voters are self-interested but politicians are not.

Answer Questions 15 and 16 based upon the information conveyed in the following table, which states Ann's Total Benefits from consumption of iced coffee per week (measured in dollars):

| | | | | | | | | |
|--|---|------|------|-------|-------|-------|-------|-------|
| <i>Cups of Iced Coffee Consumed</i> | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| <i>Total Benefits from Consumption</i> | 0 | 5.00 | 9.50 | 13.50 | 17.00 | 20.00 | 22.50 | 24.50 |

15. It appears as if Ann has a __for iced coffee consumption.
 - A. constant marginal benefit
 - B. increasing marginal benefit
 - C. diminishing marginal benefit
 - D. negative marginal benefit
16. How many cups of iced coffee Ann should consume at the cost \$2.25 per cup?
 - A. 0
 - B. 4
 - C. 6
 - D. 7

Chapter 1 Study Guide Answers

1. D
2. A
3. B
4. D
5. A

6. C
7. C
8. A
9. A
10. D
11. A
12. B
13. C
14. C
15. C
16. C