

Ch 01: Essay

1. If economics is correct in its assumption that people are rational, why then would anyone choose to smoke cigarettes?

ANSWER: Even though the harmful effects of cigarette smoking are documented, more than 20 percent of the U.S. adult population continues to smoke. The economic model of rational choice suggests that individuals weigh the marginal benefit of smoking an additional cigarette (the pleasure obtained) against the marginal costs (the pecuniary cost, the price of the cigarette, and the risk of being afflicted by smoking-related diseases, discounted by the probability). Since the likelihood of getting a smoking-related disease increases with age, it is not surprising that more people elect to give up the habit as they get older.

2. A radio station gives "free money" to those listeners whose names are drawn and announced over the airwaves from postcards the listeners sent into the radio station. Is the money really free for the listener?

ANSWER: While most students can identify the monetary cost of the postcard and stamp, we also must consider the opportunity cost of listening to the radio. It is true that we can do other activities while the radio is on and listen attentively when a name is drawn and announced over the airwaves. But there's also the opportunity cost of not being able to listen to another station, one that might offer more preferred programming.

3. Why would a radio station give money to listeners? Does this violate the economic way of thinking?

ANSWER: Radio stations do surveys to see what types of prizes listeners want (for example, cars, boats, vacations, etc.). Overwhelmingly, people say they want cash. A radio station that gives away money attracts listeners, and the more listeners a station has, the more it can charge advertisers. The owners of the radio station clearly believe the revenue this activity generates, in terms of advertising dollars, exceeds the money given away.

4. William observes that a car in 1925 sold for an average of \$500 versus \$20,000 for a 2005 model. He concludes that 2005 cars must be 40 times better than 1925 cars. What's wrong with this way of thinking?

ANSWER: Poor William has made several errors. First, a 1925 car differs substantially from a 2005 car. As the saying goes, he is comparing apples and oranges. Second, the value of the dollar has declined; William, therefore, is using as his measure a unit that has changed sizes. This is like measuring one room with a 50-inch stick and another room with a 20-inch stick. We can give both measures in terms of sticks, but they are not very comparable.

5. Evaluate this statement: "People engaged in economizing behavior will always buy the lowest priced item they can find."

ANSWER: As long as price is the only factor, we would expect people to buy the lowest priced product. However, once we consider quality, ease of operation, performance, durability, looks, etc., we can see why people would not necessarily buy the lowest priced item. While people generally seek products that yield the most benefits relative to costs, a product that can provide additional benefits would lead to a willingness to pay a higher price.

6. Homeowners can deduct interest payments on their mortgages from their federal income tax. If this deduction were removed, how would the housing market be affected?

ANSWER: The deductibility of these interest payments is an attractive feature of home ownership. If this deduction were removed, we would expect fewer people choosing to own their own homes. Additionally, we would expect to see more families in rental housing.

7. If people are self-interested, why does anyone give money to public radio?

ANSWER: Since people can listen to public radio without having to contribute, we know this can create a funding problem. However, since the economic concept of enlightened self-interest is broader than a narrow, selfish view, we would see people making this choice as contributing to their own interests. These people consider public radio good for their community. They value their community's well-being and, therefore, support public radio.

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8. When Mother Theresa won the Nobel Peace Prize, the monetary award was well in excess of \$100,000. Did she accept the money? If so, what did she do with it?

ANSWER: Mother Theresa used the money to help the poor, whom she spent a lifetime assisting. While we consider Mother Theresa to have been one of the most unselfish of people, it is clear that she could have gained more of what she valued if she had more money.

9. Who is more likely to drive carelessly, Camila in her 1980 Ford with bad brakes or Samantha, who has a 2005 BMW with all the most recent safety options?

ANSWER: On the surface, we might conclude that Samantha will be more careful since she appears to have more to lose (a higher priced car), but insurance likely will cover any monetary loss. Most people value their life and health more than material possessions; because of this, we expect Camila to be more careful due to her unsafe car. Samantha can afford to take more risks since her car is in better condition and has the latest safety features.

10. A popular video program, used to teach primary school children about economics, defines scarcity as "when you don't have enough of something." Evaluate this definition based on your understanding of the scarcity concept.

ANSWER: This definition is a bit simplistic for college understanding. The video uses the example of three hats and four children to assert a scarcity of hats. We would more properly view this as a shortage of hats created because the hats, as presented, have no price. The shortage can be eliminated but scarcity cannot. Scarcity is the fundamental concept from which economics derives. Besides resources, virtually all other things, including your time, are scarce. Your textbook's definition will serve you better than the one from the video.