**Introduction to the Economic Way of Thinking**

**Questions and Problems**

**Questions:**

1. Define scarcity. Give an example of how you confront scarcity in your day-to-day life.
2. Define opportunity cost. Give an example of the opportunity cost of a decision you made recently.
3. What are the key differences between a command economy and a market economy? In your opinion, which is more likely to produce the goods and services that consumers want?
4. Would you characterize the U.S. economy as a “mixed” economy? Why or why not?
5. What do we mean by division of labor and specialization of labor? Give an example based on what you have observed at a fast-food restaurant.
6. What do we mean when we say that economic models are abstractions or simplifications of reality?
7. Define the phrase *ceteris paribus*. Why is it so important that we invoke *ceteris paribus* when we analyze the relationship between two economic variables?
8. Classify the following statements as positive or normative statements (you don’t have to agree or disagree with the statements in order to classify them as positive or normative).
   1. If 30 percent of the orange crop is destroyed due to a freeze, the price of orange juice will rise.
   2. Income should be distributed fairly.
   3. Monthly rents for apartments in the city should be based on the income of the renter.
   4. If the price of gasoline rises, the effect on consumption in the short term will be very small.
   5. A cut in the state income tax for small business will lead to an increase in the number of jobs provided.

**Answers:**

1. Scarcity refers to the limited nature of society’s resources, given its unlimited wants. Scarcity applies to individuals and households as well. Examples should refer to the budget constraint that individuals face so they can’t buy and car and take a vacation, etc.
2. Opportunity cost is the value of the next best alternative to the one you’ve chosen.
3. The key differences are ownership of resources and allocation of resources to the production of goods and services. In a command economy, the government owns all or most of the country’s resources. In a market economy, resources are mostly privately-owned. In a command economy, production goals or quotas for goods and services are determined by central planners. In a market economy, they’re determined by the interaction between supply and demand.
4. The best answer is yes, the U.S. economy can be characterized as a mixed economy. Even though most resources are privately owned and most production of goods and services occurs in the private sector, the government is an important player in the economy through taxation, regulation and antitrust legislation. Government spending also accounts for about 17% of total GDP.

1. The division of labor means that workers are assigned to specific tasks in a production process rather than each worker performing all tasks. Specialization is an inevitable outcome of the division of labor that occurs as workers gain more experience in their specific tasks. In a typical fast food operation, workers will be assigned to taking orders, doing food prep, manning the grill, etc.
2. We mean that economic models do not fully reflect reality. Economic models (like models in all fields of inquiry) strive to capture only the essential elements of the relationship between variables.
3. *Ceteris paribus* means the “all other things are held equal”. It’s essential that we invoke *ceteris paribus* when we analyze the relationship between two economic variables because there are other variables that may have in independent effect on one or both the variables whose relationship we’re examining.
4. …
5. A positive statement that could be verified by looking at price and quantity data.
6. A normative statement that reflects a value judgment on what is fair.
7. A normative statement that reflects a value judgment on how goods and services ought to be distributed.
8. A positive statement that could be verified by examining data on price change and sales of gasoline over a defined period of time.
9. A positive statement that could be analyzed with an economic model.