



CENGAGE

Economics

Roger Arnold • Daniel Arnold • David Arnold

14E



Dear Student,

Life is full of questions, both big and small. “What time is our final exam going to be on Thursday?” is a small question. But “What is the meaning of life?” is a big question.

Small questions often have obvious answers. But when it comes to the big questions, people ponder over them for hundreds of years and still have a hard time definitively answering them.

Most questions in life fall somewhere between the small and the big. They don't have obvious answers, but they still can be answered. However, in order to answer these questions, we need to proceed a certain way. Science is often that way. Sciences such as physics, chemistry, and biology seek to answer certain questions.

Economics is a science, too, and it exists to answer questions like these: Why are some nations rich and others poor? What determines the income you earn, the prices you pay, or whether you are employed or unemployed? Why are house prices higher in San Francisco than in Indianapolis? How do you go about deciding to buy another hamburger, or another shirt? Why do some people become lawyers and others become teachers, plumbers, or software engineers? Why does it cost \$939 to rent a U-Haul to drive from Los Angeles to Phoenix but only \$189 to go the other way, from Phoenix to Los Angeles? Why is medical care so expensive? What causes prices in general to rise or fall? Why is the inflation rate higher in some countries relative to other countries? What causes recessions? Why were interest rates high in the late seventies but are relatively low today?

Think of this book as a set of questions on one side of a river and a set of answers on the other side. The way we get from questions to answers is with economics. Its theories, concepts, and ways of thinking, as you will soon see, will build that bridge on which we will travel from questions to answers.

Before we leave you to get started learning economics, we want to tell you a little about the structure of this book. There are three major parts to it. First, there is the main content of the book—that includes the words and diagrams in each chapter. It's the “meat and potatoes” of the economics course.

Second, there are various boxed and stand-alone features in each chapter—such as *Economics 24/7*, *Thinking Like an Economist*, *Finding Economics*, and *Office Hours*. The features apply what has been learned in the “meat and potatoes” of the text. Learning to apply economics will enable you to use economics to answer your own questions.

Third, there are numerous instructional videos with this book—such as *Video Lectures*, *Economics in 5 Minutes*, *What's Wrong with This Diagram?* and more. These videos not only help you learn the main content of the book but also help you work with and fully understand the many diagrams in it.

As you proceed on your economics journey, keep in mind that it takes sustained effort—and some patience—to learn economics. As you will soon find out, the effort is well worth it. Best of luck to you as you begin your study of economics.

Best Wishes,

Roger A. Arnold • Daniel R. Arnold • David H. Arnold

Economics



Economics

Fourteenth Edition

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Economics, 14e

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Designer: Chris Doughman

Cover Image Source: W. Phokin/Shutterstock.com
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WCN: 02-300

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Library of Congress Control Number: 2021921067

ISBN: 978-0-357-72037-0

Cengage

200 Pier 4 Boulevard
Boston, MA 02210
USA

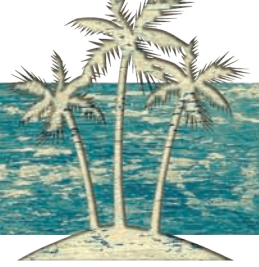
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Printed in the United States of America
Print Number: 01 Print Year: 2022

*In memory of Craig Rader.
A staunch believer in and shining example
of the power of learning and education.*

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Preface



This is the fourteenth edition of *Economics*. In it you will find three new chapters—chapters that will be particularly relevant to economic students in the early-to-mid 2020s. They are:

- Creative Destruction and Crony Capitalism: Two Forces on the Economic Landscape Today
- Health Economics: Experiments, Disparities, and Prices
- New Frontiers in Economic Research: Causal Inference and Machine Learning

With these three new chapters, students will learn what creative destruction is and how it plays out in today's world, what crony capitalism is and why it exists, what various health economic experiments tell us about how and why people buy health care and health insurance, how economists conduct research, how they infer causality, and how big data and machine learning are being used to make policy decisions. Creative destruction, crony capitalism, health care, research, data, and machine learning—this is much of the world today, and it is important for students to have the information, analytic tools, and ways of thinking to understand it.

This edition keeps much of what adopters have liked about previous editions. The content remains straightforward and accessible and comes with numerous boxed applications. We believe that economics has a lot to say these days and we want that communication between text and student to be as crystal clear, unambiguous, and accessible as possible. But to enrich the basic economic content, there need to be applications. Students need to see the basic economic tools of analysis being used to explain things, and here is where the applications come in. A hallmark of this text over various editions is the plentiful and relevant applications it features. This edition has 185 boxed applications that can be found under these four main titles: *Economics 24/7*, *Thinking Like an Economist*, *Finding Economics*, and *Office Hours*. A few of the many new ones to this edition include:

- Movie Studios vs Netflix: Incentives Matter
- The Future: Looking at Automation and Jobs
- Is Labor Being Misallocated Across U.S. Cities?
- Google, Facebook, Monopoly, and Property Rights
- Covid-19 and Health Disparities
- The Covid-19 Pandemic and the PPF
- Stoic Philosophy, Search Engines, and Consumers' Surplus
- Central Bank Digital Currency (CBDC): What Does the Future Hold?
- The Median Voter Model and the U.S. Supreme Court in 2018
- Netflix and Big Data
- The DOJ, FTC, Google, and Facebook
- Spurious Correlations
- Artificial Intelligence, Robotics, and the Future of Jobs

A major rewriting and reorganization of material covering money and banking and the Federal Reserve and monetary policy exists in this new edition. This rewriting and reorganization makes it clearer than ever how monetary policy was conducted before October 2008 and how it is conducted today.

This edition carries forward the video content, first started in earlier editions. There are two sets of instructional videos—*Economics in 5 Minutes* and *Video Lectures; What's Wrong with This Diagram?* videos; and *Problem Walk-Through* videos. The different types of videos are all instructional and designed to complement the chapter text material.

Supplements to the Text

A wide and helpful array of supplements is available with this edition to both students and instructors.

- An Instructor's Manual, written by Noreen Templin, Butler Community College, contains chapter summaries, chapter objectives, supplements, activities and assessments, and chapter outlines. It is available on the text website at <http://www.cengage.com> for instructors only.
- PowerPoint Slides, revised by Noreen Templin, Butler Community College, are available on the text website for use by instructor for enhancing their lectures. These fully accessible PowerPoint slides provide chapter-level presentations and highlight opportunities for increased peer-peer interactivity.
- A Test Bank, authored and revised for the fourteenth edition by Peggy Crane, Southwestern College, is delivered via Cognero, an online assessment system that supports the computerized Test Bank. Cognero allows instructors to create and assign tests, deliver tests through a secure online test center, and have the complete reporting and data dissemination at their fingertips.

In Appreciation

Many colleagues have contributed to the success of this text over the last thirteen editions. Their feedback continues to influence and enhance the text and ancillary package and we're grateful for their efforts. Now into our 14th edition, space dictates that we can no longer list the names of all reviewers for each past edition; we are including here instructors who contributed to the development of the 14th edition, but continue to be grateful for the improvements suggested by all of the reviewers and contributors to this product over the years.

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We are indebted to all the outstanding and creative people we worked with on the 14th edition. Chris Rader, product manager; Colleen Farmer, senior content manager; Shannon Aucoin, subject matter expert; Eugenia Belova, subject matter expert; Sarah Keeling, senior learning designer; John Carey, executive marketing manager; and Peggy Crane of Southwestern College; and Noreen Templin of Butler Community College. There are a host of activities that go on behind the scenes when producing a book. The authors' names are on the book's cover, but really it is a team of people who end up tending to the 1,001 details that make the book what it is. It is hard to imagine a better team of creative, conscientious, and dedicated publishing professionals to work with anywhere.

Roger A. Arnold Daniel R. Arnold David H. Arnold

What Economics Is About



Introduction

You are about to begin your study of economics. Before discussing particular topics in economics, we think it best to give you an overview of what economics is and of some of the key concepts. The key concepts can be compared to musical notes: Just as musical notes are repeated in any song (you hear the musical note G over and over again), the key concepts in economics are repeated too. Some of these concepts are scarcity, opportunity cost, efficiency, marginal decision making, incentives, and exchange.

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1-1 Your Life, 2024–2034

What will your life be like during the years 2024–2034? What kind of work will you do after college? How much will you earn in that first job after college? Where will you be living, and who will be your friends? How many friends will you have? Will you buy a house in the next few years? If so, how much will you pay for the house? And, perhaps most importantly, will you be happy?

The specific answers to these questions and many more have to do with economics. For example, the salary you will earn has to do with the economic concept of *opportunity cost*. What you will do in your first job after college has to do with the *state of the economy* when you graduate. The price you pay for a house has to do with the state of the *housing market*. How many friends you have has to do with the economic concept of *scarcity*. Whether you are happy will depend on such things as the *net benefits* you receive in various activities, the *utility* you gain by doing certain things, and more.

In this chapter, we begin our study of economics. As you read the chapter (and those which follow), ask yourself how much of what you are reading is relevant to your life today and tomorrow. Ask: What does what I am reading have to do with *my* life? Our guess is that after answering this question a few dozen times, you will be convinced that economics explains much about your present and future.

1-2 A Definition of Economics

In this section, we discuss a few key economic concepts; then we incorporate knowledge of these concepts into a definition of economics.

1-2a Goods and Bads

Economists talk about *goods* and *bads*. A **good** is anything that gives a person **utility**, or satisfaction. Here is a partial list of some goods: a computer, a car, a watch, a television set, friendship, and love. You will notice from our list that a good can be either tangible or intangible. A computer is a tangible good; friendship is an intangible good. Simply put, for something to be a good (whether tangible or intangible), it only has to give someone utility or satisfaction.

A **bad** is something that gives a person **disutility** or dissatisfaction. If the flu gives you disutility or dissatisfaction, then it is a bad. If the constant nagging of an acquaintance is something that gives you disutility or dissatisfaction, then it is a bad.

People want goods, and they do not want bads. In fact, they will pay to get goods (“here is \$1,000 for the computer”), and they will pay to get rid of bads (“I’d be willing to pay you, doctor, if you can prescribe something that will shorten the time I have the flu”).

Can something be a *good* for one person and a *bad* for another person? Smoking cigarettes gives some people utility; it gives others disutility. We conclude that smoking cigarettes can be a *good* for some people and a *bad* for others. This must be why people tell their loved ones, “If you want to smoke, you should do it outside.” In other words, “Get those *bads* away from me.”

1-2b Resources

Goods do not just appear before us when we snap our fingers. It takes resources to produce goods. (Sometimes *resources* are referred to as *inputs* or *factors of production*.)

Generally, economists divide resources into four broad categories: *land*, *labor*, *capital*, and *entrepreneurship*.

- **Land** includes natural resources, such as minerals, forests, water, and unimproved land. For example, oil, wood, and animals fall into this category. (Sometimes economists refer to the category simply as *natural resources*.)
- **Labor** consists of the physical and mental talents that people contribute to the production process. For example, a person building a house is using his or her own labor.
- **Capital** consists of produced goods that can be used as inputs for further production. Factories, machinery, tools, computers, and buildings are examples of capital. One country might have more capital than another; that is, it has more factories, machinery, tools, and the like.
- **Entrepreneurship** refers to the talent that some people have for organizing the resources of land, labor, and capital to produce goods, seek new business opportunities, and develop new ways of doing things.

1-2c Scarcity and a Definition of Economics

We are now ready to define a key concept in economics: *scarcity*. **Scarcity** is the condition in which our wants (for goods) are greater than the limited resources (land, labor, capital, and entrepreneurship) available to satisfy those wants. In other words, we want goods, but not enough resources are available to provide us with all the goods we want.

Look at it this way: Our wants (for goods) are infinite, but our resources (which we need to produce the goods) are finite. Scarcity is the result of our infinite wants hitting up against finite resources.

Good

Anything from which individuals receive utility or satisfaction.

Utility

The satisfaction one receives from a good.

Bad

Anything from which individuals receive disutility or dissatisfaction.

Disutility

The dissatisfaction one receives from a bad.

Land

All natural resources, such as minerals, forests, water, and unimproved land.

Labor

The work brought about by the physical and mental talents that people contribute to the production process.

Capital

Produced goods—such as factories, machinery, tools, computers, and buildings—that can be used as inputs for further production.

Entrepreneurship

The talent that some people have for organizing the resources of land, labor, and capital to produce goods, seek new business opportunities, and develop new ways of doing things.

Scarcity

The condition in which our wants are greater than the limited resources available to satisfy those wants.

Many economists say that if scarcity didn't exist, neither would economics. In other words, if our wants weren't greater than the limited resources available to satisfy them, there would be no field of study called economics. This is similar to saying that if matter and motion didn't exist, neither would physics or that if living things didn't exist, neither would biology. For this reason, we define **economics** in this text as the science of scarcity. More completely, *economics is the science of how individuals and societies deal with the fact that wants are greater than the limited resources available to satisfy those wants.*

Economics

The science of scarcity; the science of how individuals and societies deal with the fact that wants are greater than the limited resources available to satisfy those wants.

Thinking Like an Economist

Scarcity Affects Everyone Everyone in the world—even a billionaire—has to face scarcity. Billionaires may be able to satisfy more of their wants for tangible goods (houses, cars) than most people, but they still may not have the resources to satisfy all their wants. Their wants might include more time with their children, more friendship, no disease in the world, peace, and a hundred other things that they don't have the resources to "produce."

Thinking in Terms of Scarcity's Effects Scarcity has effects, such as the need to make choices, the need for a rationing device, and competition.

Choices People have to make choices because of scarcity. Because our unlimited wants are greater than our limited resources, some wants must go unsatisfied. We must choose which wants we will satisfy and which we will not. Mia asks, "Do I go to Hawaii or do I pay off my car loan earlier?" Alex asks, "Do I buy the new sweater or two new shirts?"

Need for a Rationing Device A **rationing device** is a means of deciding who gets what of available resources and goods. Scarcity implies the need for a rationing device. If people have infinite wants for goods and if only limited resources are available to produce the goods, then a rationing device is needed to decide who gets the available quantity of goods. Dollar price is a rationing device. For instance, 100 cars are on the lot, and everyone wants a new car. How do we decide who gets what quantity of the new cars? The answer is to use the rationing device called *dollar price*. The people who pay the dollar price for a new car end up with one.

Rationing Device

A means for deciding who gets what of available resources and goods.

Scarcity and Competition Do you see competition in the world? Are people competing for jobs? Are states and cities competing for businesses? Are students competing for grades? The answer to all these questions is yes. The economist wants to know why this competition exists and what form it takes. First, the economist concludes, competition exists because of scarcity. If there were enough resources to satisfy all our seemingly unlimited wants, people would not have to compete for the available, but limited, resources.

Second, the economist sees that competition takes the form of people trying to get more of the rationing device. If dollar price is the rationing device, people compete to earn dollars. Look at your own case. You are a college student working toward a degree. One reason (but perhaps not the only reason) you are attending college is to earn a higher income after graduation. But why do you want a higher income? You want it because it will allow you to satisfy more of your wants.

Suppose muscular strength (measured by lifting weights), instead of dollar price, were the rationing device. Then people with more muscular strength would receive more resources and goods than people with less muscular strength. In that case, people would compete for muscular strength. (They would spend more time at the gym lifting weights.) The lesson is simple: *Whatever the rationing device is, people will compete for it.*

Finding Economics

At the Campus Bookstore To learn economics well, you must practice what you learn. One of the ways to practice economics is to find it in everyday life. Consider the following scene: You are in the campus bookstore buying a book for your computer science course, and you are handing \$85 to the cashier. Can you find the economics in this simple scene? Before you read on, think about it for a minute.

Let's work backward to find the economics. You are currently handing the cashier \$85. We know that dollar price is a rationing device. But let's now ask ourselves why we would need a rationing device to get the book. The answer is scarcity. In other words, scarcity is casting its long shadow there in the bookstore as you buy a book. We have found one of the key economic concepts—scarcity—in the campus bookstore. (If you also said that a book is a good, then you have found even more economics in the bookstore. Can you find more than scarcity and a good?)

Self-Test

(Answers to Self-Test questions are in Answers to Self-Test Questions at the back of the book.)

1. True or false? Scarcity is the condition of finite resources. Explain your answer.
2. How does competition arise out of scarcity?
3. How does choice arise out of scarcity?

1-3 Key Concepts in Economics

A number of key concepts in economics define the field. We discuss a few of these concepts next.

1-3a Opportunity Cost

So far, we have established that people must make choices because scarcity exists. In other words, because our seemingly unlimited wants push up against limited resources, some wants must go unsatisfied. We must therefore *choose* which wants we will satisfy and which we will not. The most highly valued opportunity or alternative forfeited when we make a choice is known as **opportunity cost**. Every time you make a choice, you incur an opportunity cost. For example, you have chosen to read this chapter. In making this choice, you denied yourself the benefits of doing something else. You could have watched television, sent text messages to a friend, taken a nap, eaten a few slices of pizza, read a novel, shopped for a new computer, and so on. Whatever you *would have chosen* to do is the opportunity cost of your reading this chapter. For instance, if you would have watched television instead of reading this chapter—if that was your next best alternative—then the opportunity cost of reading the chapter is watching television.

There Is No Such Thing as a Free Lunch Economists are fond of saying that “there is no such thing as a free lunch.” This catchy phrase expresses the idea that opportunity costs are incurred whenever choices are made. Perhaps this is an obvious point, but consider how often people mistakenly assume that there *is* a free lunch. For example, some parents think that education is free, because they do not pay tuition for their children to attend public elementary school. That's a misconception. “Free” implies no sacrifice and no opportunities forfeited, but an elementary school education requires resources that could be used for other things.

Opportunity Cost

The most highly valued opportunity or alternative forfeited when a choice is made.

Consider the people who speak about free medical care, free housing, free bridges (“there’s no charge to cross it”), and free parks. Again, free medical care, free housing, free bridges, and free parks are misconceptions. The resources that have been used to provide medical care, housing, bridges, and parks could have been used in other ways.

Economics 24/7

Rationing Spots at Yale

Each year, Yale University receives more applications for admission to the freshman class than spots are available. In most years, for every 100 applications for admission that Yale receives, it can accept only seven applicants for admission. What Yale has to do, then, is ration its available admission spots.

How does it ration its available spots? One way is simply to use money as a rationing device. In other words, raise the dollar amount of attending Yale to a high enough level so that the number of spots equals the number of students willing and available to pay for admission. To illustrate, think of Yale as auctioning off spots in its freshman class. It calls out a price of \$50,000 a year, and at this price, more people wish to be admitted to Yale than there are spots available. Yale keeps on raising the price until the number of students who are willing and able to pay the tuition is equal to the number of available spots. Maybe this price is, say, \$200,000.

As we know, Yale does not ration its available spots this way. In fact, it uses numerous rationing devices in an attempt to whittle down the number of applicants to the number of available spots. For example, it might use the rationing device of high school grades. Anyone with a GPA in high school of less than, say, 3.50 is not going to be admitted. If, after doing this, Yale still has too many applicants, it might then make use of the rationing device of standardized test scores. Anyone with an SAT score of less than, say, 1300 is eliminated from the pool of applicants. If there are still too many applicants, then perhaps other rationing devices will be used, such as academic achievements, community service, degree of interest in attending Yale, and so on.



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Yale might also decide that it wants to admit certain students over others, even if the two categories of students have the same academic credentials. For example, suppose Yale wants at least one student from each state in the country, and only 10 students from Wyoming have applied to go to Yale whereas 500 students from California have applied. Then Yale could very well use the rationing device of state diversity

to decide in favor of the student from Wyoming instead of the applicant from California.

In the first week of April each year, Yale sends out many more rejection letters than acceptance letters. There is no doubt some students who are rejected by Yale feel that some of the students who were accepted might not be as academically strong as they are. The student with a 4.00 GPA and a perfect SAT score of 1600 may feel he was slighted by Yale when he learns that a student in his high school with a 3.86 GPA and SAT score of 1350 was chosen over him. What did the 3.86–1350 student have that he didn’t have? On what rationing device benchmark did the rejected student score lower?

In life, you will often hear people arguing over what the rationing device for certain things should be. Should high school grades and standardized test scores be the only two rationing devices for college admission? What role should money play as a rationing device when a high school graduate applies to college? What role should ethnic or racial diversity, or state diversity, or income diversity play in the application process? Our point is a simple one: With scarcity comes the need for a rationing device. More people want a spot at Yale than there are spots available. Yale has to use one or more rationing devices to decide who will be accepted and who will be rejected.

Thinking Like an Economist

Zero Price Doesn't Mean Zero Cost A friend gives you a ticket to an upcoming concert for zero price (i.e., you pay nothing). Does it follow that zero price means zero cost? No. There is still an opportunity cost of attending the concert. Whatever you would be doing if you don't go to the concert is the opportunity cost of attending. To illustrate, if you don't attend the concert, you would hang out with friends. The value you place on hanging out with friends is the opportunity cost of your attending the concert.

1-3b Opportunity Cost and Behavior

Economists believe that a change in opportunity cost can change a person's behavior. For example, Darnell, who is a sophomore at college, attends classes Monday through Thursday of every week. Every time he chooses to go to class, he gives up the opportunity to do something else, such as earn \$15 an hour working at a job. The opportunity cost of Darnell's spending an hour in class is \$15.

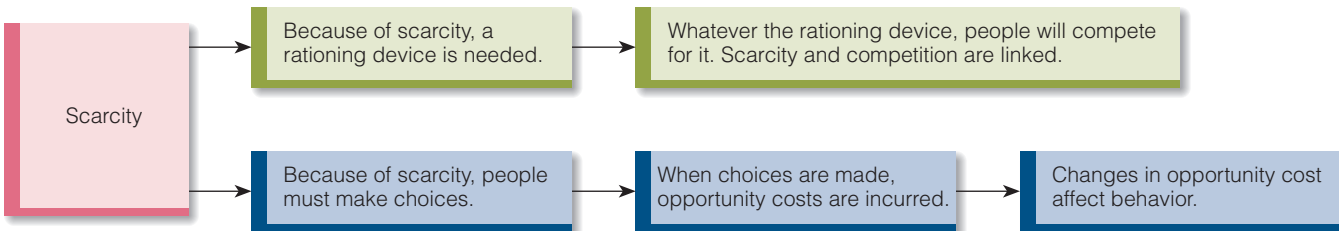
Now let's raise the opportunity cost of attending class. On Tuesday, we offer Darnell \$70 to skip his economics class. He knows that if he attends his economics class, he will forfeit \$70. What will Darnell do? An economist would predict that as the opportunity cost of attending class increases relative to the benefits of attending, Darnell is less likely to go to class.

This is how economists think about behavior: *The higher the opportunity cost of doing something, the less likely it is that it will be done.* This is part of the economic way of thinking.

Look at Exhibit 1, which summarizes some of the things about scarcity, choice, and opportunity cost up to this point.

EXHIBIT 1

Scarcity and Related Concepts



Finding Economics

In Being Late to Class Jordan is often a few minutes late to his biology class. The class starts at 10 a.m., but Jordan usually walks into the class at 10:03 a.m. The instructor has asked Jordan to be on time, but Jordan usually excuses his behavior by saying that the traffic getting to college was bad or that his alarm didn't go off at the right time or that something else happened to delay him. One thing the instructor observes, though, is that Jordan is never late when it comes to test day. He is usually in class a few minutes before the test begins. Where is the economics?

We would expect behavior to change as opportunity cost changes. When a test is being given in class, the opportunity cost of being late to class is higher than when a test is not being given and the instructor is simply lecturing. If Jordan is late to class on test day, he then has fewer minutes to complete the test, and having less time can adversely affect his grade. In short, the higher the opportunity cost of being late to class, the less likely it is that Jordan will be late.

1-3c Benefits and Costs

If we could eliminate air pollution completely, should we do it? If your answer is yes, then you are probably focusing on the *benefits* of eliminating air pollution. For example, one benefit might be healthier individuals. Certainly, individuals who do not breathe polluted air have fewer lung disorders than people who do breathe polluted air.

But benefits rarely come without costs. The economist reminds us that, although eliminating pollution has its benefits, it has costs too. To illustrate, one way to eliminate all car pollution tomorrow is to pass a law stating that anyone caught driving a car will go to prison for 40 years. With such a draconian law in place and enforced, very few people would drive cars and all car pollution would be a thing of the past. Presto! Cleaner air! However, many people would think that the cost of obtaining that cleaner air is too high. Someone might say, “I want cleaner air, but not if I have to completely give up driving my car. How will I get to work?”

What distinguishes the economist from the noneconomist is that the economist thinks in terms of *both costs and benefits*. Often, the noneconomist thinks in terms of one or the other. Studying has its benefits, but it has costs too. Coming to class has benefits, but it has costs too. Getting up early each morning and exercising has its costs, but let’s not forget that there are benefits too.

1-3d Decisions Made at the Margin

It is late at night, and you have already spent three hours studying for tomorrow’s biology test. You look at the clock and wonder if you should study another hour. How would you summarize your thinking process? What question or questions would you ask yourself to decide whether to study another hour?

Perhaps without knowing it, you think in terms of the costs and benefits of further study. You probably realize that studying an additional hour has certain benefits (you may be able to raise your grade a few points), but it has costs too (you will get less sleep or have less time to watch television or talk on the phone with a friend). *That* you think in terms of costs and benefits, however, doesn’t tell us *how* you think in terms of costs and benefits. For example, when deciding what to do, do you look at the *total costs* and *total benefits* of the proposed action, or do you look at something less than the total costs and benefits? According to economists, for most decisions, you think in terms of *additional*, or *marginal*, costs and benefits, not *total* costs and benefits. That’s because most decisions deal with making a small, or additional, change.

To illustrate, suppose you just finished eating a hamburger and drinking a soda for lunch. You are still a little hungry and are considering whether to order another hamburger. An economist would say that, in deciding whether to order another hamburger, you compare the additional benefits of the second hamburger with its additional costs. In economics, the word *marginal* is a synonym for *additional*. So, we say that you compare the **marginal benefits (MB)** of the (next) hamburger to its **marginal costs (MC)**. If the marginal benefits are greater than the marginal costs, you obviously expect a net benefit of ordering the next hamburger, and

Marginal Benefits (MB)

Additional benefits; the benefits connected with consuming an additional unit of a good or undertaking one more unit of an activity.

Marginal Costs (MC)

Additional costs; the costs connected with consuming an additional unit of a good or undertaking one more unit of an activity.

therefore, you order another. If, however, the marginal benefits are less than the marginal costs, you obviously expect a net cost of ordering the next hamburger, and therefore, you do not order another. Logically, the situation is as follows:

Condition	Action
MB of next hamburger $>$ MC of next hamburger	Buy next hamburger
MB of next hamburger $<$ MC of next hamburger	Do not buy next hamburger

Decisions at the Margin

Decision making characterized by weighing the additional (marginal) benefits of a change against the additional (marginal) costs of a change with respect to current conditions.

What you don't consider when making this decision are the *total* benefits and *total* costs of hamburgers. That's because the benefits and costs connected with the first hamburger (the one you have already eaten) are no longer relevant to the current decision. You are not deciding between eating two hamburgers or eating no hamburgers; your decision is whether to eat a second hamburger after you have already eaten one.

According to economists, when individuals make decisions by comparing marginal benefits with marginal costs, they are making **decisions at the margin**. The employee makes a decision at the margin in deciding whether to work two hours overtime; the economics professor makes a decision at the margin in deciding whether to put an additional question on the final exam.

Economics 24/7

When Is It Too Costly to Attend College?

Look around your class. Are there any big-name actors, sports stars, or comedians between the ages of 18 and 25 in your class? Probably not. The reason is that, for these people, the opportunity cost of attending college is much higher than it is for most 18-to-25-year-olds. Think of Chris Rock, a comedian, and Emma Stone and Ryan Gosling, both actors. These people and many more like them chose not to go to college. Why didn't they go? The fact is that they didn't go to college because it was too expensive for them to go to college. Not "too expensive" in the sense that the "tuition was too high," but expensive in terms of what they would have had to give up if they attended college—expensive in opportunity cost terms.

To understand this idea, think of what it's costing you to attend college. If you pay \$7,000 tuition a semester for eight semesters, the full tuition amounts to \$56,000. However, \$56,000 is not the full cost of attending college, because if you were not a student, you could be earning income working at a job. For example, you could be working at a full-time job earning \$42,000 annually. Certainly, this \$42,000, or at least part of it if you are currently working part time,



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is forfeited because you are attending college. It is part of the total cost of your attending college.

The *tuition cost* may be the same for everyone who attends your college, but the *opportunity cost* is not. Some

people have higher opportunity costs of attending college than others. It just so happens that Chris Rock, Emma Stone, and Ryan Gosling had extremely high opportunity costs of attending college. Each would have to give up hundreds of thousands of dollars if he or she were to attend college on a full-time basis.

Simply put, our story illustrates two related points we have made in this chapter. First, earlier we said that *the higher the opportunity cost of doing something, the less likely it will be done*. The opportunity cost of attending college is higher for some people than others, and that is why not everyone who can pay for college chooses to attend college.

Second, we said that economists believe that *individuals think and act in terms of costs and benefits and that they undertake actions only if they expect the benefits to outweigh the costs*. Thus, Chris Rock, Emma Stone, and Ryan Gosling saw certain benefits to attending college—just as you see certain benefits to attending college. But those benefits—although they may be the same for you and everyone else—are not enough to get everyone to attend college. That's because the benefits are not all that matters. The costs matter too. In the case of Chris Rock, Emma Stone, and Ryan Gosling, the costs of attending college were much higher than the benefits, so they chose not to attend college. In your case, the benefits are higher than the costs, so you have decided to attend college.

1-3e Efficiency

What is the right amount of time to study for a test? In economics, the *right amount* of anything is the *optimal* or *efficient* amount—the amount for which the marginal benefits equal the marginal costs. Stated differently, you have achieved **efficiency** when the marginal benefits equal the marginal costs.

Suppose you are studying for an economics test, and for the first hour of studying, the marginal benefits (*MB*) are greater than the marginal costs (*MC*):

$$MB \text{ studying first hour} > MC \text{ studying first hour}$$

Given this condition, you will certainly study for the first hour, because it is worth it: The additional benefits are greater than the additional costs, so there is a net benefit to studying.

Suppose, for the second hour of studying, the marginal benefits are still greater than the marginal costs:

$$MB \text{ studying second hour} > MC \text{ studying second hour}$$

Then you will study for the second hour, because the additional benefits are still greater than the additional costs. In other words, studying the second hour is worthwhile. In fact, you will continue to study as long as the marginal benefits are greater than the marginal costs. Exhibit 2 illustrates this discussion graphically.

The *MB* curve of studying is downward sloping because we have assumed that the benefits of studying for the first hour are greater than the benefits of studying for the second hour and so on. The *MC* curve of studying is upward sloping because we have assumed that studying the second hour costs a person more (in terms of goods forfeited) than studying the first hour, studying the third hour costs more than studying the second, and so on. (If we assume that the additional costs of studying are constant over time, the *MC* curve is horizontal.)

In the exhibit, the marginal benefits of studying equal the marginal costs of studying at three hours. So, three hours is the *efficient* length of time to study in this situation. At less than three hours, the marginal benefits of studying are greater than the marginal costs; thus, at all these hours, studying has net benefits. At more than three hours, the marginal costs of studying are greater than the marginal benefits, so studying beyond three hours is not worthwhile.

Efficiency

Exists when marginal benefits equal marginal costs.