

## Chapter 1

# ECONOMIC ACTIVITY IN CONTEXT

*Essentials of Economics in Context* (Goodwin, et al.), 1<sup>st</sup> Edition

### Chapter Overview

This chapter introduces you to the basic concepts that underlie the study of economics. We define economics as “the study of how people manage their resources to meet their needs and enhance their well-being.” This definition is much broader than most traditional definitions of economics where the focus is on market behavior. We explicitly discuss intermediate vs. final goals and treat efficiency and GDP growth as considerations in the achievement of final goals, not final goals in themselves. We define the well-being goals of economics in terms of (1) living standards growth, (2) stability and security, and (3) financial, social, and ecological sustainability. The four essential economic activities are resource management, the production of goods and services, the distribution of goods and services, and the consumption of goods and services. As you work through this book, you will learn in detail about how economists analyze each of these areas of activity.

### Objectives

After reading and reviewing this chapter, you should be able to:

1. Define the difference between microeconomics and macroeconomics
2. Define the difference between normative and positive questions.
3. Differentiate between intermediate and final goals.
4. Understand efficiency.
5. Understand economic growth measured by GDP.
6. Identify and describe the three broader economic goals.
7. Define the four essential economic activities.
8. Understand the five types of capital that contribute to productivity.
9. Illustrate tradeoffs using a production possibilities frontier.
10. Discuss the relationship between abundance and scarcity.
11. Understand what is meant by “economics in context.”

### Key Terms

economics

well-being

microeconomics

macroeconomics

positive questions

normative questions

intermediate goal

final goal

gross domestic product (GDP)

efficiency

standard of living

business cycle

technological progress  
conscious consumption  
restorative development  
contextual economics  
resource management  
capital  
natural capital  
manufactured capital  
human capital  
social capital  
financial capital  
investment  
production  
inputs  
outputs

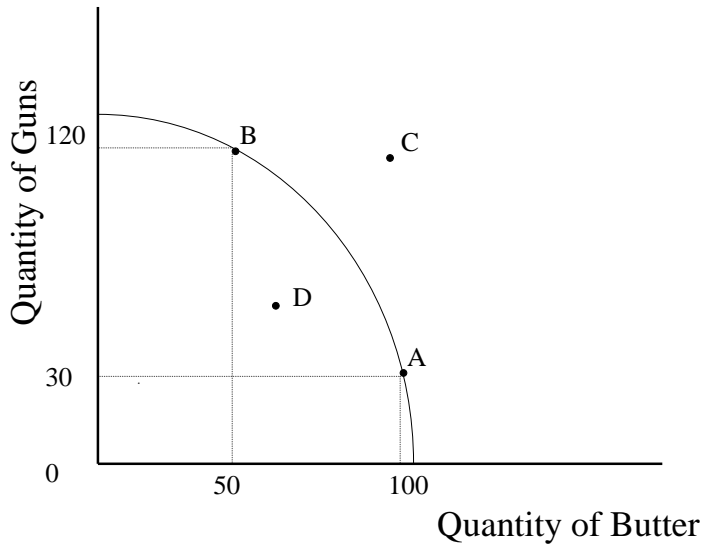
waste products  
stock  
flow  
stock-flow diagram  
distribution  
exchange  
transfer  
in-kind transfers  
consumption  
saving  
abundance  
scarcity  
production-possibilities frontier (PPF)  
opportunity cost

### Active Review Questions

*Fill in the blank*

1. You buy a new book. If you didn't buy the book, you would have purchased a pizza instead. Economists would call the pizza your \_\_\_\_\_ of buying the book instead.
2. While the study of economic activities of individuals, households, and business at the sub-national level is the concern of \_\_\_\_\_, the study of economic activities of the national and global level is the concern of \_\_\_\_\_.
3. Questions about facts or "how things are" are about \_\_\_\_\_ values and "how things should be" are \_\_\_\_\_.
4. The three main macroeconomic goals identified in this chapter are \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_.
5. Protecting wildlife in a national park is an example of the economic activity of \_\_\_\_\_.
6. Your grandmother sends you a check for \$100. This form of resource distribution is referred to as a \_\_\_\_\_.
7. A diagram that shows the tradeoffs between production of two goods is called a(n) \_\_\_\_\_.

Questions 8 to 10 refer to the production possibilities frontier shown below.



*True or false*

8. In the graph shown above, at point B, society is producing the maximum possible amount of butter.
9. To move from point A to point B, society would have to cut down on its gun production and increase butter production.
10. Starting from point B, society would have to invest substantial resources to increase gun production.
11. Microeconomics is the study of national and international economic trends.
12. Watching a movie is an example of “consumption.”
13. Living standards growth is defined as increases in the level of production in a country or region.

*Short answer*

14. Name the four essential economic activities.

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15. “Children should learn to clean up after themselves by the age of six.” Is this a positive or a normative statement? \_\_\_\_\_

16. “The business sphere contributed 64% of production in the US in 2016.” Is this a positive or a normative statement? \_\_\_\_\_

17. List the three basic economic questions.

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18. Why is the goal of stability and security important to many people? What problems typically emerge during periods of instability?

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19. The goal of sustainability requires that we address what three questions?

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20. What are the two main forms of economic distribution? What is the difference between them?

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21. A family enjoys a three-week vacation. In order to afford this vacation, the family saved money over the course of a year. Was earning this money a final goal or an intermediate goal?

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22. Technological innovations can vastly increase a society’s productive capacity. How might a technological innovation affect a society’s production possibilities frontier?

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### Self Test

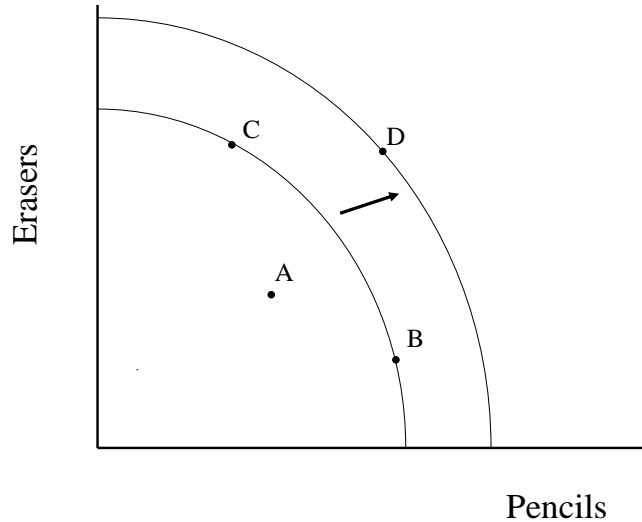
1. With what kinds of topics does macroeconomics concern itself?
  - a. Economic activities of individual firms, households, and other organizations
  - b. Forces of supply and demand in a particular market
  - c. Consumer behavior and firms output decisions
  - d. The labor market, wages, and hiring decisions
  - e. Aggregate economic phenomena like the rate of unemployment and inflation

2. Which of the following best exemplifies an intermediate goal?
  - a. Spending a relaxing vacation with your family.
  - b. Spending a day at the art gallery.
  - c. Going fishing for fun.
  - d. Getting a summer job so you can afford a trip abroad.
  - e. Reading a novel.
  
3. Which of the following statements is positive (as opposed to normative)?
  - a. One should always be polite at the dinner table.
  - b. There are ten people in this class.
  - c. A young person's top priority should be job security.
  - d. The best professor is one who meets with students individually each week.
  - e. Resources should be distributed equally across society.
  
4. Which of the following is an example of a normative question?
  - a. What is the nation's rate of economic growth?
  - b. What is the nation's rate of inflation?
  - c. What is the nation's rate of unemployment?
  - d. What is the nation's level of GDP?
  - e. Is the goal of sustainability of greater importance than the goal of economic growth?
  
5. Enjoying art at a museum is an example of ...
  - a. Production
  - b. Consumption
  - c. Exchange
  - d. Transfer
  - e. Resource management
  
6. Which of the following statements is *false*?
  - a. Final goals could include fairness, freedom, or a sense of meaning in one's life.
  - b. You are offered a very interesting job, but you need a car to get there. Getting a car is an example of a final goal.
  - c. Resource management refers to activities associated with tending to, preserving, or improving natural, social, and other resources.
  - d. Production is the conversion of resources into goods or services.
  - e. Distribution is the sharing of products and resources among people.

7. Which of the following is an example of the economic activity of resource management?
- cooking dinner
  - operating a factory
  - providing worker education
  - drilling for oil
  - buying a bicycle
8. Which of the following factors could expand a society's production possibilities frontier?
- Increased butter production.
  - Shifting from one product to another.
  - Producing air pollution.
  - Depleting resources now instead of later.
  - Technological innovations.
9. Which of the following is an example of the economic activity of distribution?
- A baker makes 10 loaves of bread.
  - A plumber fixes a leak.
  - The legal speed limit is raised from 65 to 75 mph.
  - A couple enjoys a walk in the forest.
  - A retired worker receives Social Security benefits.
10. Which of the following is an example of the economic activity of consumption?
- A baker makes 10 loaves of bread.
  - A plumber fixes a leak.
  - The legal speed limit is raised from 65 to 75 mph.
  - A couple enjoys a walk in the forest.
  - A retired worker receives Social Security benefits.
11. What does the Production Possibilities Frontier represent?
- A catalog of all possible production options, represented as percentages.
  - The tradeoffs between production and consumption options.
  - The tradeoffs between possible production levels for two goods.
  - The amount that a society could produce if it devoted all its resources to producing one good.
  - The possible gains from international trade in two or more goods.

**Questions 12 and 13 refer to the following scenario.**

An economy produces two goods: pencils and erasers. The graph shown below depicts two possible production possibilities frontiers (PPFs) for this economy.



12. Which of the following events could cause the economy to move from point B to point D?
- a. Workers become less productive due to poor working conditions.
  - b. A hurricane destroys vital resources for pencil production.
  - c. A new machine is invented that makes it easier to produce both pencils and erasers.
  - d. All production costs rise proportionally.
  - e. The cost of eraser inputs goes up.
13. Which of the following statements is true?
- a. Moving from point C to point B requires shifting resources away from eraser production and into pencil production.
  - b. Point B represents a less efficient resource mix than point C.
  - c. Depletion of nonrenewable resources could lead the economy to shift from point C to point D.
  - d. Utility is maximized at point A.
  - e. At point A, society is producing all the pencils it can.

14. The nation of Anyplace produces two goods, chairs and tables. Anyplace can produce the chairs and tables using either sustainable methods or resource-depleting methods. If Anyplace chooses resource-depleting methods, which of the following statements is true?

- a. Eventually the PPF of Anyplace will shift outward (away from the origin).
- b. Eventually the PPF of Anyplace will shift inward (toward the origin).
- c. Eventually the PPF of Anyplace will pivot, causing a change in the slope of the curve.
- d. Eventually Anyplace will have to choose between producing only chairs or producing only tables.
- e. None of the above.

15. Suppose there is a production possibilities frontier (PPF) for wine and cheese. Which of the following situations would shift the PPF inward (toward the origin)?

- a. A severe weather event that destroys much of the economy's productive capacity.
- b. Discovery of a new, cheaper source of milk for making cheese.
- c. Increased popularity of wine, as compared with cheese.
- d. A technological breakthrough.
- e. Improved education of the work force.

16. In general, as production of a good increases, the opportunity cost of production increases. How is this notion reflected in the graph of production possibilities frontier (PPF)?

- a. The PPF bows inwards (that is, looks like a slide or a valley)
- b. The PPF bows outwards (that is, looks like a hillside).
- c. The PPF shifts in response to technological change.
- d. The PPF shows production of one good at a time.
- e. The PPF becomes flatter as resource availability increases.

17. Which of the following is one of the three macroeconomic goals discussed in the text?

- a. Growth in the size of corporations
- b. Living standards growth
- c. Growth in trade and globalization
- d. Technological innovation
- e. None of the above.



18. Which of the following are the three dimensions of sustainability as discussed in the text?
- a. Ecological, financial, and social sustainability
  - b. Ecological, financial, and political sustainability
  - c. Ecological, financial, and cultural sustainability
  - d. Ecological, technological, and human sustainability
  - e. Ecological, technological, and social sustainability
19. Which of the following is *not* an issue concerning social sustainability?
- a. The disparities between the “haves” and the “have-nots.”
  - b. The ability of the next generation to contribute to a healthy economy and society
  - c. The need for steady growth in production
  - d. The creation of social disruption and political strife
  - e. The ability of the next generation to experience social and political participation and inclusion.
20. Which of the following best describes the notion of conscious consumption?
- a. making consumption choices based on advertisements
  - b. making consumption choices based on price of goods
  - c. making consumption choices considering the environmental and social consequences of the choices made
  - d. making consumption choices based on cultural influences
  - e. making consumption choices based on income levels

## Answers to Active Review Questions

1. opportunity cost
2. microeconomics, macroeconomics
3. positive, normative
4. living standards growth, stability and security, and sustainability
5. resource maintenance
6. transfer
7. production possibilities frontier
8. False. Society could produce more butter by producing fewer guns.
9. False. To move from A to B, society would have to decrease butter production and increase gun production.
10. True. At point B, society is already employing many of its resources to produce guns. Increasing gun production further will present high opportunity costs.
11. False. Microeconomics focuses on activities that take place within and among the major economic organizations of a society. Macroeconomics is the study of broader patterns in the national and international economy.
12. True. An experience can be “consumed” without using up material resources.
13. False. Economic growth, not living standards growth, is defined as increases in the level of production in a country or region.
14. production, distribution, consumption, and resource management
15. normative
16. positive
17. What should be produced and maintained? How? For whom?
18. The instability over the business cycle can be accompanied by high rates of unemployment, which is associated with falling incomes and social stress, like suicide, domestic violence, illness and crime. Alternatively the instability may result in inflation, which can erode the purchasing power of income, or wipe out the value of savings and pensions.
19. The goal of sustainability requires that we address whether economic activities are financially sustainable, whether they are socially sustainable, and whether they are ecologically sustainable.
20. Exchange and transfer. Exchange occurs when one actor provides a good or service, or money, in return for something else. Transfer is a one-way transaction, when one actor gives something to another.
21. intermediate
22. A technological innovation can expand the production possibilities frontier (move it “out,” away from the origin).

## Answers to Self Test Questions

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| 1. e | 11. c |
| 2. b | 12. c |
| 3. d | 13. a |
| 4. e | 14. b |
| 5. b | 15. a |
| 6. b | 16. b |

7. c  
8. e  
9. e  
10. d

17. b  
18. a  
19. c  
20. c