<u>**Discussion Questions**</u>

<u>Chapter 1</u>

1. The Widespread Reach of Economics -*Chris Downs*
Explain why the science of economics is concerned with the activity of households and individuals at one end of the scale, and that of multinational corporations and governments at the other.

2. Equity vs. Efficiency - *Chris Downs*
It is a principle of economics that society faces trade-offs and one of these trade-offs is between the goals of equity and efficiency. Explain the terms equity and efficiency and discuss which of the two you think is the more important? Why might government policies aimed at achieving the goal you think is the more important lead to a reduction in the other goal?

3. The Benefits of Trade -*Peter Thiel*
Economists generally believe that trade is good for society. Do you think trade is good for society? Give your views on the matter, making sure to support your answer with a carefully thought out explanation.

<u>Chapter 2</u>

1. Normative vs. Positive -*Chris Downs*
Explain what is meant by normative and positive analysis. Bearing in mind that economics deals with important social and political issues, do you think that economists are ever able to conduct positive analysis without being influenced by their own normative judgements?

2. What Makes a Good Model -*Chris Downs*
The circular flow diagram is an example of an economic model; it's a model of the economy as a whole. How simplified is this model? What are your feelings about the likely usefulness of this model?

<u>Chapter 3</u>

1. Comparative Advantage -*Peter Thiel*
The principle of comparative advantage predicts that two nations will benefit from trade with each other, even if one nation is better –in absolute terms– than the other in producing all goods. Carefully explain using appropriate examples how this is possible.

2. Controversy over International Trade -*Chris Downs*
It is sometimes argued that free trade is a bad thing since it leads to job losses and makes countries dependent on others so that difficulties would arise in the event of a war. Discuss these arguments, thinking in particular about the growth of China as a manufacturer and exporter, and about the contribution of the European Union to maintaining peace in Europe since 1945.

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Chapter 4

1. Perfectly Competitive Markets and the Real World - *Peter Thiel*
Few markets in the real world have the characteristics of a perfectly competitive market. Does that mean that the predictions of the model of perfect competition are not very useful in predicting how markets in the real world work? Discuss.

2. Market Equilibrium - *Peter Thiel*
When market equilibrium occurs, quantity demanded is equal to quantity supplied, which means that both sellers and buyers get what they want. Does a market reach market equilibrium on its own, or is it necessary to have some sort of regulator to manage the price and ensure there is equilibrium? Explain your answer carefully.

3. Using Markets to Achieve Policy Objectives -*Chris Downs*
Do you consider raising the price of cigarettes to be a good way to reduce the amount people smoke? Explain your answer carefully.

Chapter 5

1. The Importance of Elasticity -*Chris Downs*
Why is the concept of elasticity important to (a) firms and (b) governments?

2. Changing Elasticity Along the Demand Curve -*Peter Thiel*
If a demand curve is a downward sloping straight line, every segment of that demand curve will have a different elasticity. Explain in detail, with the aid of examples, why this is so.

3. Income Elasticity and Share Purchases - *Peter Thiel*
Suppose you are thinking about buying some company shares, which you plan to keep for at least ten years. How could you use the concept of income elasticity of demand to guide you in selecting the most promising company in which to invest?

Chapter 6

1. Price Ceilings in Competitive Markets - *Peter Thiel*
Governments are frequently tempted to introduce price ceilings in markets. Use an example to explain why this is not such a good idea, at least when markets are competitive. Give some ideas as to what the government could do instead in order to help consumers in these markets.

2. The Minimum Wage Law - *Peter Thiel*
Many countries around the world have some sort of minimum wage law. Explain why the minimum wage may hurt workers as much as help them. Give some ideas as to how the government could help workers more effectively.

3. Tax Incidence -*Peter Thiel*

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Governments may impose a tax aimed specifically at the consumer or at the firm. Explain why both firms and consumers will end up paying part of the burden of the tax, regardless of on whom the government levies the tax. Describe the circumstances under which consumers end up paying a bigger share of the tax and explain why this is so.

Chapter 7

1. Trade and Surplus -*Peter Thiel*
When two individuals trade two goods, they both end up being better off as a result of the transaction. Explain how this can be possible, in spite of the fact that the exchange itself creates nothing new (the goods being traded are still the same as they were before being traded). Use an example to illustrate your explanation.

2. Surplus and Efficiency -*Peter Thiel*
When a market is in equilibrium, the total surplus created by the market is usually maximized. Explain why this is so and give some examples of circumstances when this might not be so.

Chapter 8

1. Taxes and Deadweight loss - *Peter Thiel*
The text indicates that when a tax is imposed, it usually creates a deadweight loss. The deadweight loss represents part of the total surplus that is lost due to the tax. Explain what happened to that lost surplus: where did it go?

2. The Laffer Curve -*Peter Thiel*
The Laffer curve indicates that when an excise tax is increased too much, tax revenues can actually decrease. Explain carefully how this can happen. Use an example to illustrate your explanation.

Chapter 9

1. Trade is Good for Importing Countries -*Peter Thiel*
Welfare economics establishes that even importing countries are better off with trade. Explain how this is possible in spite of the fact that imports cause domestic firms to suffer and makes many workers lose their jobs.

2. Fair Trade -*Peter Thiel*
Many policy makers believe that we should open up for free trade with other nations only if these nations reciprocate by allowing our products to flow freely into their markets. Do you agree with this opinion? Or do you believe –as most economists do– that we should eliminate trade barriers all together, regardless of what other nations do? Explain your answer carefully.

3. Tariffs vs. Quotas -*Peter Thiel*
Discuss the relative merits of tariffs and quotas. Which of the two usually causes less damage to the economy? Under what circumstances will they yield the same welfare outcome? Why?

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Chapter 10

1. Technology Spillovers as Positive Externalities - *Chris Downs*
Positive externalities result in market failure just as do negative externalities. Discuss different types of policy response to the market failure that can result from technology spillovers. Are these policy responses likely to bring about market efficiency? Do they have any drawbacks?

2. Environmentalists vs. Economists -*Peter Thiel*
Environmentalists would love to see any type of pollution banned completely. Do you agree with them? Or do you side with most economists, who argue that some pollution is better for society than none at all. Explain your answer carefully.

3. Regulation vs. Taxes -*Peter Thiel*
According to economic theory, both regulation and Pigovian taxes are able to solve a problem of negative externalities. Which of the two do you think is better: regulation or taxes? Under what circumstances will both yield essentially the same outcome? Why?

Chapter 11

1. Public Goods and the Free Rider Problem -*Peter Thiel*
Explain why public goods cause a "free rider" problem, why this leads public goods markets to produce less than is optimal, and why the government is in a better position to provide such goods than private firms.

2. Cost Benefit Analysis -*Chris Downs*
The BBC World Service broadcasts are effectively public goods: anyone with a radio can listen and consumption is non-rival. In 2005 the BBC announced it was to close certain services aimed at Eastern European countries in order finance the introduction of new ones aimed at audiences elsewhere. Explain why it would be advisable to undertake some cost-benefit analysis before making such a decision. Discuss some of the difficulties those doing this cost-benefit analysis would face. Why would a commercial radio station, financed by revenue from advertising, not need to undertake cost-benefit analysis before deciding to close, say, a folk music radio service?

3. Motorways and Common Resources -*Chris Downs*
The network of motorways in the UK is in fact a common resource: no drivers are excluded from using the motorways. However, drivers frequently encounter heavy traffic, illustrating that there is rivalry in consumption of the network. Should overcrowded motorways be widened with additional lanes, or should the UK follow the example of some European countries and introduce tolls for using the motorways? Explain your answer carefully.

Chapter 12

1. The Flat Tax -*Chris Downs*
A flat tax is justifiable on grounds of equity since such a system must be either proportional or progressive; it can never be regressive. Discuss this statement.

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2. The Corporate Tax -*Chris Downs*
Corporation tax is popular because it is seen as a tax on impersonal businesses rather than people. Is this way of viewing corporation tax sensible? Support your answer with a carefully thought out explanation.

Chapter 13

1. Law of Diminishing Marginal Product -*Peter Thiel*
Why is it that, in the short-run, after a certain number of workers have been hired, output increases by less and less with each additional worker hired? Illustrate your answer with an example. Would there be any circumstances under which this phenomenon would not occur? Discuss.

2. Economies of Scale - *Peter Thiel*
'When small firms get bigger (increase their scale), they frequently see their costs decrease'. Do you agree with this statement? Explain your answer.

Chapter 14

1. Demand Faced by the Firm -*Peter Thiel*
How is it possible that a firm in a perfectly competitive market is able to sell all it wants without having to change the price? What does this tell us about the elasticity of demand faced by the firm?

2. Profit Maximization Rules -*Peter Thiel*
If profit is the difference between revenue and cost, how can it be that profit is maximized when marginal revenue equals marginal cost?

3. Zero Economic Profits -*Peter Thiel*
Explain the mechanism that will lead all firms in a perfectly competitive market to end up earning zero economic profits in the long run.

Chapter 15

1. Natural Monopoly -*Peter Thiel*
Explain what a natural monopoly is. Why is it that, even though a natural monopolist might be earning high economic profits, other firms will still decline to enter the industry and compete against the incumbent?

2. Marginal Revenue in a Monopoly -*Chris Downs*
When a firm sells an additional unit of the good it produces, it receives in exchange money worth the price of the good. Explain why, when a monopolist sells an extra unit, its marginal revenue is less than the price while this is not true for a firm in a perfectly competitive market?

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3. Perfect Price Discrimination, Perfect Competition, and Efficiency -*Peter Thiel*
Compare a price discriminating monopoly to a perfectly competitive industry in terms of efficiency. Which of these two market structures is best for society?

Chapter 16

1. Demand in Monopolistic Competition -*Peter Thiel*
A monopolistically competitive industry has many firms, just as in perfect competition. Why is it then that firms in monopolistic competition face a downward sloping demand curve, when firms in perfect competition face a horizontal demand curve?

2. Monopolistic Competition and Efficiency -*Peter Thiel*
Compare the short-run and long-run equilibriums in monopolistic competition with those in perfect competition. Pay particular attention to the issue of efficiency.

Chapter 17

1. Size of an Oligopoly -*Peter Thiel* Explain why it is that the larger the number of firms in an oligopoly, the lower the price, the greater the quantity produced, and the smaller the profits. If you can, explain how an oligopoly determines its output.

2. Strategic Thinking in Oligopoly -*Peter Thiel* Firms in oligopoly must constantly think in terms of how other firms in the industry will react to whatever they do. Why do they have to do this? Why is it that firms in perfect competition and in monopoly don't have to worry about how other firms will react?

3. Collusion and Cheating -*Peter Thiel*
A cartel allows firms to behave as a monopoly and so, earn much higher profits. Why is it then that firms in a cartel frequently cheat, leading to the collapse of the cartel? What can firms in a cartel do to prevent cheating from occurring in the first place?

Chapter 18

1. Value of the Marginal Product of Labour -*Peter Thiel*
Explain the role that the value of the marginal product of labour plays in determining how many workers a firm should hire. Why is the value of the marginal product more useful than the marginal product in determining the optimal number of workers?

2. Rental Price and Purchase Price of Inputs -*Peter Thiel*
Which determines which: do rental prices of land determine purchase prices, or is it the other way around? Explain your answer carefully, using the concept of the value of the marginal product.

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Chapter 19

1. Value of the Marginal Product and Wage Differences - *Peter Thiel*
Use the concept of the Value of the Marginal Product to explain why some people – such as sports stars or big company chief executives – are paid extremely high wages, while most other people are paid much lower wages.

2. Human Capital Vs. Signalling -*Peter Thiel*
Explain the difference between the human capital theory and the signalling theory in how they explain how better educated people earn higher wages. Discuss the differences in the policies suggested by each of these theories. Which of the two theories do you believe to be more valid? Explain your answer carefully.

Chapter 20

1. Income Inequality -*Chris Downs* A common way of measuring income inequality is to calculate the share of total income received by the poorest quintile (20%) of households and by households in the four higher quintiles (see table 20.2 in the text). Should we be concerned about income inequality in society as measured in this way? Explain your answer carefully.

2. Anti-Poverty Policy -*Chris Downs* Are all policies to reduce poverty bound to have undesired effects that discourage the poor from taking action to improve their economic position themselves?

Chapter 21

1. Consumer Theory vs. Real Consumers -*Peter Thiel*
Consumer theory assumes consumers are rational. Furthermore, it works with indifference curves, budget constraint lines, and optimization. Explain how studying this theory can be of any use, given that consumers in the real world never use indifference curves or budget constraint lines to make decisions.

2. Indifference Curves Never Cross -*Peter Thiel*
One of the characteristics of indifference curves is that they never cross. Why is this so? What would go wrong if they did cross? Support your explanation with the use of an example.

3. Marginal Rate of Substitution and Relative Prices -*Peter Thiel*
When the consumer chooses the optimal combination of goods, the Marginal Rate of Substitution ends up being equal to the relative prices of the two goods being purchased. Explain carefully what this means.

Chapter 22

1. Asymmetric Information -*Chris Downs*
Explain how asymmetric information might lead to problems in the market for used cars that should make you wary of buying a used car. How might used car dealers who sell high quality

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cars overcome the problem?

2. Median Voter Theorem -*Peter Thiel*
Use the Median Voter Theorem to explain why extremist political positions tend to have little effect on the political process. Discuss under what circumstances this might not be the case.

Chapter 23

1. Income and Expenditure Approaches to Measuring GDP - *Peter Thiel*
Why is it that measuring a nation's expenditure should yield the same value as measuring a nation's income? Why is it that such a value represents GDP?

2. GDP and Well-Being - *Chris Downs*
How satisfactory is GDP as a measure of economic well-being in a country? Explain your answer.

Chapter 24

1. CPI vs. GDP Deflator -*Peter Thiel*
The inflation measured by CPI is significantly different from that measured by the GDP deflator. Why is it that these will tend to be different even if they are measured with perfect accuracy? Is one of the two a better measure of inflation?

2. Adjusting for Inflation -*Peter Thiel*
You frequently hear in the news that the latest film is the biggest blockbuster ever, earning record revenues in the first weekend of release, and so on. Why is it that such statements are misleading? What should reporters do to report such events more accurately? Why don't they do so?

Chapter 25

1. Capital Accumulation -*Peter Thiel*
Discuss the various strategies that a government could follow in order to promote investment and so, the accumulation of physical capital.

2. Property Rights -*Peter Thiel*
Discuss the importance of property rights in promoting economic growth and prosperity. Why is it virtually impossible for prosperity to take place without clear–and properly enforced–property rights?

3. Population Growth -*Peter Thiel*
Discuss why rapid population growth does not help promote per capita economic growth. How is it that rapid population growth tends to reduce the productivity of labour?

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Chapter 26

1. Stocks vs. Bonds -*Peter Thiel*
Suppose a firm wishes to invest in a risky venture (e.g. develop a new product that could be very popular, but that might flop instead). Should it finance this venture by issuing shares or bonds? Discuss.

2. Taxes and Saving -*Chris Downs*
Explain why the tax systems in many countries tend to discourage saving. How could tax systems be changed to encourage saving? What arguments might be made against such a change?

Chapter 27

1. Risk and Diversification - *Chris Downs*
Explain why an investor might not wish to buy shares in a company that she believes have a 50-50 chance of doubling in value or becoming worthless. How can diversification help such an investor? What is the limit of what can be achieved by our investor through diversifying?

2. Efficient Market Hypothesis - *Peter Thiel*
Do you believe that financial markets are efficient? Do you believe that the prices of shares and bonds perfectly reflect all the publicly available information? Explain your answer thoroughly.

Chapter 28

1. Measuring Unemployment -*Chris Downs*
Explain the two basic ways in which unemployment is measured. Which is the more reliable? Explain your answer.

2. Equilibrium in Labour Market - *Peter Thiel*
When the labour market is in equilibrium, it means that the number of jobs in the economy is equal to the number of people willing and able to work (the labour force). Why is it then that there will always be unemployment in the economy, even when the labour market is in equilibrium (even when there is a job for everyone)?

Chapter 29

1. Commodity Money -*Chris Downs*
Salt, cigarettes and conch shells have all been used as money and are example of commodity money. How well do such examples of money perform, measured against the three functions of money?

2. How Banks Create Money -*Peter Thiel*
Explain in detail how commercial banks create money when they lend money. Does the money commercial banks create exist physically? Use a numerical example to support your answers.

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3. Tools of Monetary Control -*Chris Downs*
What are the tools of monetary control used by central banks, such as the Bank of England, the European Central Bank and the US Federal Reserve? Why cannot central banks fully control the money supply?

<u>Chapter 30</u>

1. Money Demand -*Peter Thiel*
Explain the concept of money demand and discuss how money demand will be affected if prices rise in the economy.

2. Principle of Monetary Neutrality - *Peter Thiel*
Discuss the Principle of Monetary Neutrality and explain why it should work. Do you believe this principle always holds true?

3. Inflation -*Chris Downs*
Much effort is made to keep inflation down. How severe a problem is inflation in reality?

<u>Chapter 31</u>

1. Net Capital Outflow and the Real Exchange Rate -*Peter Thiel*
Why is it that, as long as we don't expect the exchange rate to change, the exchange rate has no effect on how much money we choose to invest or lend abroad? Use an example to support your answer.

2. Purchasing Power Theory -*Peter Thiel*
Explain the mechanism that makes the nominal exchange rate adjust to purchasing power parity. Discuss the sort of events that might make the exchange rate move away from the purchasing power parity.

3. The Competitiveness of a Nation -*Peter Thiel*
"The purchasing power parity theory renders meaningless the concept of a nation being competitive or uncompetitive." Discuss.

<u>Chapter 32</u>

1. The Effect of the Government Budget -*Chris Downs*
For a country with an open economy, such as the UK, an increase in the government budget deficit will also lead to a worsening of the country's trade balance. Use the model developed in chapter 32 to explain this statement.

2. Effect of Foreign Interest Rates - *Peter Thiel*
If foreign interest rates rise, this will cause the net capital outflow to increase, but it will also cause domestic interest rates to increase. Since domestic interest rates cause the net capital outflow to decrease, what will really happen to the net capital outflow: will it increase or decrease?

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3. The Effect of Import Quotas -*Chris Downs*
In the summer of 2005 the EU imposed import quotas on textile imports from China, only a few months after earlier restrictions had been abolished, leading to much controversy. Explain why, even if the quotas led to reduced textile imports (that is, assuming that reducing Chinese imports did not lead to increased imports from, say, India) economists would expect the effect on the overall EU trade balance to be zero.

Chapter 33

1. Keynesian Ideas – *Andrew Ashwin*
'The world in 1936 was very different to the world today. It is not surprising that Keynesian ideas have no relevance today.' Do you agree with this statement? Explain your reasoning.

2. The Role of the Rate of Interest – *Andrew Ashwin*
Explain how the rate of interest is crucial in linking the goods market and the money market and thus providing the basis for a theory of general equilibrium.

3. The Relevance of IS-LM Analysis – *Andrew Ashwin*
Would you agree that IS-LM analysis has little relevance for explaining the way modern economies work?

Chapter 34

1. The Short Run Aggregate Supply Curve -*Peter Thiel*
Use the Sticky Wage theory to explain why firms, in the short-run, will choose to increase output when prices rise in the economy, and also why they will choose to cut output back to its original level in the long-run.

2. Effects of a Change in Aggregate Demand -*Peter Thiel*
Consider an economy that is in a state of long-run equilibrium. What will happen to this economy in the short-run if the government cuts its spending drastically (say, to meet a new balanced budget law)? Discuss how the economy will return to long-run equilibrium.

Chapter 35

1. Liquidity Preference Theory – *Peter Thiel*
When interest rates rise, people demand less money. How can people demand less money and yet continue spending the same amount per month as before? Discuss.

2. The Central Bank and Aggregate Demand – *Peter Thiel*
The money multiplier effect enhances the central bank's actions, which gives it great power over the economy. But does increasing the money supply also trigger the expenditure multiplier effect? Discuss.

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3. Monetary vs. Fiscal Policy – *Peter Thiel*
Which of the two policies is more powerful: monetary policy or fiscal policy? Discuss.

Chapter 36

1. The Trade-Off Implied by the Phillips Curve – *Peter Thiel*
Paul Samuelson and Robert Solow concluded that the government faced a trade-off between unemployment and inflation: the government had to choose whether to follow policies that reduced unemployment at the expense of high inflation or policies of low inflation at the expense of high unemployment. Wht did they conclude this? Why were they wrong in this assessment?

2. Inflation Targeting – *Chris Downs*
At the time of writing (November 2010), the US Federal Reserve does not have an explicit inflation target, whilst both the Bank of England and the European Central Bank do. What are the pros and cons of the Fed's approach and the Bank of England's approach?

Chapter 37

1. Moral Hazard – *Andrew Ashwin*
Most banks are privately owned companies which exist for the benefit of their shareholders. As a result, should they stand and fall as a result of the actions of those who manage the bank? Explain your answer.

2. The Financial Crisis – *Andrew Ashwin*
Where would you lay the blame for the financial crisis – on the banks who took higher risk positions, on regulators who failed to monitor the situation effectively, on central banks that should have known better, on greedy traders seeking to enhance their bonuses or on the general public for 'presuming' prosperity would continue? Justify your answer.

3. The Quants – *Andrew Ashwin*
If the people behind quantitative analysis of risk in markets were so brilliant why did they create such a mess?

4. The Global Recession – *Andrew Ashwin*
Was a global recession inevitable? Explain your answer.

Chapter 38

1. The Eurozone's Stability and Growth Pact (SGP) – Chris Downs
Why do you think the SGP was established at the outset of the European single currency? Do you think the SGP, as originally agreed, was an economically sensible policy? Explain your answer.

2. Real Wage Flexibility – *Andrew Ashwin*
One of the most important ways that EU countries can begin to reduce stubborn levels of high

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unemployment is to make their labour markets more flexible. Do you agree with this statement? Explain your reasoning.

<u>Chapter 39</u>

1. Government Macroeconomic Policy – *Chris Downs*
Should governments seek to stabilize their economies, and if so, how?

2. Budget Deficits – *Andrew Ashwin* Many European countries have introduced austerity measures to cut ballooning budget deficits. Why have they chosen to do this and do you agree that such measures are essential to helping generate long-term economic growth?

3. The Future for Economics – *Andrew Ashwin* Has the financial crisis thrown up new areas for research for economics or should we simply review the efficient markets hypothesis and look to see what Keynesian economics could teach us as a means of avoiding similar problems in the future?