

CHAPTER 2

ECONOMIC ACTORS AND ORGANIZATIONS

Microeconomics in Context (Goodwin, et al.), 2nd Edition

Chapter Overview

This chapter delves into the motivations that drive people to do what they do, and the patterns of behavior that people display. The chapter examines such issues as how people make choices, whether and when people behave rationally, the role of self-interest and altruism, and how people's choices vary with the amount of time between an action and its consequence. Traditional economic concepts are covered along with innovative concepts from psychology that have begun to enrich economic discourse in recent years.

This chapter also teaches the basic principles of a traditional economic model in which individual actors carry out a limited set of activities, subject to certain assumptions about how they will behave.

Objectives

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

1. Define the difference between economic actors and organizations.
2. Differentiate between intrinsic and extrinsic motivations.
3. Discuss the ways that economic actors make decisions.
4. Understand the importance of time discount rates for making economic decisions.
5. Define and discuss the different modes of economic coordination.
6. List the assumptions behind the traditional neoclassical model.

Key Terms

purposeful (instrumental) behavior
incentive
self-interested motivation
motivation according to the common good
constrained behavior
rational choices
satisfice
bounded rationality
low time discount rate
economic coordination
coordination by consent
markets
circular flow diagram
perfect rationality

extrinsic motivation
intrinsic motivation
altruistic motivation
habitual behavior
choice behavior
optimize
melioration
high time discount rate
individual economic actor
custom
coordination by administration
market failure
perfect information

Active Review

Fill in the Blank

1. Economists generally make the assumption of purposeful, or _____, behavior, meaning that people choose their behaviors consciously to achieve certain goals.
2. When you undertake an unpleasant task in the hopes of being paid for it, you could be described as _____ motivated.
3. A firefighter who gives up his own life to rescue a child is motivated by _____.
4. A person who works to improve the public education system in his city is working to advance the _____.
5. Circumstances that affect the options available to you, such as the offerings at a school cafeteria or the set of books available in your local library, act as _____ on your behavior.
6. Identifying and pursuing a satisfactory, rather than an optimal, outcome is referred to as _____.
7. A continuous effort to achieve a better situation than the present one is known as _____.
8. The idea that people consider some, but not all, relevant information when making a decision is included in a broad concept of _____ rationality.
9. A situation in which the market form of coordination produces inefficient or harmful results is known as _____.

True or false

10. If a man eats rice every day, that must mean he likes rice.
11. All human behavior can be as described as “choice behavior.”
12. Economists have traditionally tended to focus on the role of habit and constraints in determining behavior.
13. Psychological studies show that people always make rational choices.

14. A person who exhibits behaviors of satisficing or meliorating displays characteristics of bounded rationality.
15. A person who spends money as soon as she gets it and does not think much about the future displays a high time discount rate.
16. An organization may be composed of many individual economic actors.
17. A company could act both as an individual economic actor and as an organization.

Short answer

18. Mary belongs to a frisbee team. The team is involved in an effort to make more park space available for practice sessions and games. A reporter writes an article stating that “the local frisbee team is lobbying for more park space.” In this situation, is the team being treated as an individual economic actor or an organization? _____

19. Name the four major modes of economic coordination.

20. You help a friend with his homework and he cooks dinner for you in return. Which mode of economic coordination does this exemplify?

21. Name some examples of cases in which voluntary exchange is generally considered to be unethical.

22. Name the three economic activities that are included in the traditional model of the economy.

23. The traditional economic model assumes that production is accomplished only by firms. Explain what realities are overlooked when we make this assumption.

24. What do firms buy in the traditional economic model? What do they sell?

25. The traditional economic model assumes that consumption is done by households. What other role may households play?

Self Test

1. Which of the following cases exemplifies intrinsic motivation?

- a. A piano teacher offers many hours of lessons per day, in order to maximize her income.
- b. A young biologist works hard on preparing a lecture because he wants to impress his colleagues.
- c. A car salesman reads philosophy in his free time because he enjoys it.
- d. A computer scientist double-checks the accuracy of his code before showing it to his boss.
- e. A father of two small children makes sure to bring snacks when he picks them up from school, so they won't complain on the way home.

2. A company offers employees a bonus if they achieve a certain level of sales per week. This is an example of:

- a. habit
- b. constraint
- c. extrinsic motivation
- d. a high time discount rate
- e. satisficing

3. Which of the following statements about Adam Smith is false?

- a. Smith is the author of *The Theory of Moral Sentiments*.
- b. Smith is the author of *The Wealth of Nations*.
- c. Smith believed that there is no need for altruistic behavior.
- d. Smith's work has been used to justify views that are not necessarily supported by his writing.
- e. Smith wrote about both economic and ethical issues.

4. Some people have argued that if everyone simply follows his or her own self-interest, societal well-being will automatically result. This view overlooks

- a. The fact that people may not have all the information they need to make good decisions.
 - b. The fact that people almost always work to advance the common good.
 - c. The fact that people optimize.
 - d. The fact that people have high discount rates.
 - e. The role of markets.
5. A racist apartment building owner insists on only renting to people of one race, even though this means some apartments will stand empty and total revenues will decline. We can describe this person's motivations as being
- a. meliorative
 - b. intrinsic
 - c. extrinsic
 - d. positive
 - e. normative
6. You have a range of options for how to spend your summer, including getting a summer job, traveling abroad, or taking a summer school course. As you make plans for the summer, you are exhibiting
- a. altruism
 - b. constrained behavior
 - c. time discounting
 - d. choice behavior
 - e. perfect information
7. Which of the following is most clearly an example of constrained behavior?
- a. You decide to get Chinese food tonight because you're tired of Mexican food.
 - b. A single mother takes a night job because she can't find a day job.
 - c. A high school student works at the local supermarket to help pay for prom tickets.
 - d. An economist starts work at 8:00 AM because that is what she is used to doing every day.
 - e. A young man brings flowers to a dinner party because he wants to make a good impression on the host.
8. The term "rational behavior" is used in traditional economic models to describe behavior that *best* moves a person toward his or her goals. This behavior is known as
- a. bounded rationality
 - b. satisficing
 - c. meliorating
 - d. organizational savvy

e. optimizing

9. During her first year of college, Jean lived in a small dorm room with an annoying roommate. In her second year, she was happy because she got a room of her own, although it was still small. In her third year, she moved into a spacious apartment with a good friend. Jean's process of finding a better place to live each year could be described as:

- a. discounting
- b. custom
- c. exchange
- d. meliorating
- e. production

10. The four major modes of economic coordination are:

- a. production, consumption, consent, exchange
- b. custom, consent, administration, exchange
- c. production, consumption, transfer, exchange
- d. custom, consent, transfer, administration
- e. supply, demand, household, firm

11. Which of the following is an example of economic coordination by custom?

- a. Two lawyers, a man and a woman, decide to get married. Without discussing it, they assume that after they have their first child, the woman will quit her job while the man goes back to work.
- b. A group of neighbors form a food co-op to buy and sell organic produce.
- c. A group of steel workers form a union.
- d. An entrepreneur forms a new company to produce orange juice.
- e. Two friends decide to open a restaurant together.

12. A market failure is

- a. A situation in which regulation is inappropriate.
- b. A situation in which markets yield inefficient or harmful outcomes.
- c. A situation in which no market exists.
- d. A situation in which some people refuse to participate in the free market.
- e. A situation in which all decisions are made according to custom.

13. Which of the following is an assumption of the traditional model of the economy?

- a. Production is accomplished by firms.
- b. Production is accomplished by households.
- c. Consumption is accomplished by firms and households.
- d. Exchanges occur only among firms.

- e. People engage in meliorating behavior.
14. Which of the following elements of the economy are included in the traditional model of the economy?
- a. resource maintenance
 - b. production by households
 - c. transfers
 - d. exchange
 - e. all of the above
15. The traditional economic model assumes perfect rationality and perfect information. Which of the following situations is most consistent with the traditional economic model?
- a. You need to buy a pair of shoes. You find out what store sells the best shoes for the lowest prices, and you go shopping there.
 - b. You need to buy a pair of shoes, so you buy them at the nearest store.
 - c. You get drunk at a fraternity party because you want to impress your friends.
 - d. You don't study the night before your economics exam because your roommate is sick and needs your help.
 - e. You buy a used car without doing research beforehand, and end up paying more than the car is worth.
16. Which statement about the traditional economic model is false?
- a. It assumes the economy is composed entirely of individual economic actors.
 - b. It treats households as organizations with potentially complex internal dynamics.
 - c. It assumes that exchange is performed in markets.
 - d. It assumes all economic actors possess perfect information.
 - e. It omits consideration of resource maintenance activities.
17. Which of the following is *not* an example of economic coordination by exchange?
- a. Juan pays to get a haircut.
 - b. John mows Jean's lawn in return for dinner.
 - c. Paola gives her daughter a check to cover school expenses for the semester.
 - d. Amy works at the local food coop in return for a discount on all her purchases there.
 - e. Jamil pays for health insurance every month.
18. Which of the following statements is true?
- a. A sports team can be viewed as an individual economic actor or as an organization.

- b. The notion of bounded rationality is central to the traditional neoclassical model.
 - c. Economic coordination by exchange always produces the greatest possible good for society.
 - d. The traditional neoclassical model relies heavily on the notion of intrinsic motivation.
 - e. A person who does not care much about the future is said to have a low time discount rate.
19. Which of the following exemplifies a high time discount rate?
- a. Making sure to save money for your child's college education, even though your child is still young.
 - b. Deciding to take an expensive vacation now, even if it means not taking a vacation next year.
 - c. Taking steps to avoid water pollution, because the pollution could decrease fish yields next year.
 - d. Planting an acorn with the intention that your grandchildren will enjoy the full-grown oak tree.
 - e. Putting money away for a rainy day.
20. Which of the following situations best illustrates the concept of satisficing?
- a. Claudillo looks for a job that will pay better than his last job.
 - b. Johanna researches every possible option before she chooses what model of car she will buy.
 - c. Albert eats a peanut butter sandwich for lunch every day because that's all he can afford.
 - d. Tuan wants an affordable three-bedroom apartment. He rents the first one he finds.
 - e. Carla saves her money carefully so she can take a year off from work and write a novel.

Answers to Active Review Questions

1. instrumental
2. extrinsically
3. altruism
4. common good
5. constraints
6. satisficing
7. meliorating
8. bounded
9. market failure

10. False. The man's behavior may also reflect the constraints he faces. For example, rice may be the only food available to him, or one of a small set of food options.
11. False. Habits and constraints can also play an important role in determining behavior.
12. False. Economists have traditionally focused almost entirely on choice behavior.
13. False. Economic models often assume rationality, but this assumption is not necessarily borne out by psychological studies.
14. True.
15. True.
16. True.
17. True.
18. individual economic actor
19. custom, consent, administration, exchange
20. exchange
21. Examples in the book include buying and selling babies, buying and selling human organs, buying and selling votes or grades. Students may come up with other examples – for example, you may believe that buying and selling sex, in the form of prostitution, is an unacceptable form of voluntary exchange.
22. production, exchange, consumption
23. This assumption overlooks the production that occurs in households, as well as the services provided by actors in the public purpose sphere. It also overlooks the role of natural resources, such as forests and rivers, in providing for human needs.
24. In the traditional economic model, firms buy land, labor, and capital services, and sell produced goods and services.
25. Households play an important role in production of goods and services (such as meals, child care, and education), as well as serve important roles in distribution and resource maintenance.

Answers to Self Test Questions

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| 1. c | 11. a |
| 2. c | 12. b |
| 3. c | 13. a |
| 4. a | 14. d |
| 5. b | 15. a |
| 6. d | 16. b |
| 7. b | 17. c |
| 8. e | 18. a |
| 9. d | 19. b |
| 10. b | 20. d |