

Instructor Foreword: Fifth Edition

It is our sincere hope and intent that you will find this 'text' helpful in assisting your students to understand, or reinforce, some of the very important issues and concepts in economics. It assumes some companion instruction either in the form of lectures, standard texts, programmed materials, or distant education tutorials. It may be used as the only text *if* one or more of the other instructional methods are present.

Death on Demand is sufficiently flexible for either a traditional two semester sequence or a single semester survey course. Pedagogically, DOD fits the latter more suitably, but also serves reasonably well for a micro, macro two semester sequence. Instructors have adopted DOD for use as a supplement in both on campus (fact-to-face) classes as well as for courses taught over the web.

The humorous style represents a deliberate attempt to capture the student's interest and ease the discomfort some students feel taking a traditional economic principles course(s). The use of debates between the characters provides the student with the opportunity to see the give and take of various economic theories side by side rather than in some predetermined order (or not at all). We have attempted to weigh the arguments towards the prevailing consensus while trying not to omit major dissenting opinions.

Introduced into this edition are end-of-the chapter questions located on the Thomas Horton & Daughters web site (www.horton-daughters.com). These questions address some issues the story line otherwise precludes. Our aim is to make the student think about the issues raised and see how those issues may be extended into other aspects of human behavior.

Student Foreword: Fifth Edition

We trust you will find this 'text' a delightful departure from the standard text on the Dismal Science. The purpose of the text, as in any first course in economics, is to teach you how economists think. [To learn how to think like an economist, you will need a bit more than just one or two courses in economic principles.] That is, what is most important is that you see and understand the economic point of view of human behavior. It comes as a surprise to some students that economics is a social science. Like sociologists, criminologists, anthropologists, and psychologists, economists are students of human behavior.

Economists have a unique point of view, however. We rely on logic, mathematics and certain basic axioms of human behavior. This uniqueness makes economics for some students more difficult than other subjects. One reason is that by the time you reach college, you have had multiple years of mathematics, history, English, social studies, political science and the 'hard' sciences. However, you have had very limited, if any, previous exposure to economic principles.

To ease the transition, we have written *Death on Demand* with the express intent of putting you at ease and yet stimulating your interest in a set of very important economic (read human) issues. We hope you will enjoy the story and come away with a sense of what economics is all about and how economists think.

The Authors

Eight

Karl Teasdale's nose kept turning further up, or at least that was the way it appeared to his friend Joe. They had arrived at the Terrace Cafe a little later than usual this morning, and a number of tables were already occupied. Most of the occupants were engrossed in a discussion of Halsey's death. A newly arrived couple was hearing at least three different versions of the event from people at other tables around them. But each different story was an "I swear it's true, I heard it from someone who saw or knew or talked to" version.

When Karl first caught part of this conversation, he sniffed. But at least he went back to his corn flakes. Then he heard a remark about the death from another table, and his nostrils flared. The next time he heard something, and from a third part of the room, as well, Karl raised his head as if detecting a bad odor. He glanced at the offending party and then raised himself up to his full height.

"I do believe," Karl began to say, speaking slowly and carefully to underscore the disdain he felt for those about them, "that the climate at this hotel is becoming intolerable. I fear that, were I to attempt a game of tennis this morning, I would be subjected, between volleys, to a barrage of unfounded speculation concerning this crime from the players on either court beside me."

Joe Birnoff, in spite of appearing inattentive to the world around him, was sufficiently observant of Karl's mannerisms to have seen this coming. He also knew his best course was to remain silent in the hope that Karl's anger would exhaust itself.

But Karl could become quite offended by the petty behavior of what he only rarely would admit to calling the common people. After all, it was a luxury of the isolated life of a scholar that Karl could usually avoid such people altogether. Thus his distaste for "common people's

behavior," along with his limited experience with it, left him highly intolerant.

"I do not suppose there is another hotel in the area that is equivalent to this one in its amenities?" he asked after another look around the room.

"Now, Karl!"

"Do not 'now, Karl' me. You know I prefer a quiet and restful setting when we take these vacations. And you know, as well, what I think of rude and ill-behaved people."

"I understand that you're upset by all this gossip. I'm not so pleased by it myself. But it is inevitable human behavior. Besides, there's a humorous and, for that matter, an intellectually interesting side to it, if you look at it as a social scientist."

Karl rolled his eyes. "Don't tell me you're turning sociologist on me? Next you'll start talking about 'patterns of informal communication,' 'the consequences of rumor for the quality of information flow,' or maybe something like 'rumor as social myth.'"

"So you do know how to look at it like a social scientist!"

"Like a sociologist, I said. We have those flaky birds at Wisconsin, too, you know."

"Nonetheless, I don't believe we need do anything as radical as change hotels. Why don't we rent a car and begin touring the area? That'll get us out of the hotel."

"Are you certain we need to rent a car? Perhaps there are some good bus tours that are cheaper."

"You know you wouldn't like traveling with the herd on a bus tour. Besides, then we'd be forced to stick to their itinerary. I like making up my own. We'll have more freedom that way."

"But it always turns out to be more expensive than you say it will."

"Look at it this way," Joe offered in some exasperation. "We'll get a weekly rate and keep the car to drive ourselves back to the airport when we depart."

"That's OK if we would have rented the car at the airport in the first place. Then we could have avoided any drop-off charge." Having said this, however, Karl quickly saw the flaw in his own argument. "But there is no drop off charge, is there?"

"Correct. The desk clerk said we could rent the car here and then drop it off at the airport on our way home. You know we'll be happier in our own car. Look at it this way, maybe when we drive around you'll

see some real estate you'd want to invest in next year. Then you can probably figure out some way to write the expense of the car off your income tax. As part of the cost of the investment or something. After all, you are the tax whiz."

"We bought resort property three years ago," Karl sniffed. "But I suppose it wouldn't hurt to consider what's available here."

Joe beamed with satisfaction. He knew the way to divert Karl's mind was to get onto the subject of investments.



Karl was shaking his head as the two men sought out their car in one of the tucked away spaces of the hotel parking lot. At first, Joe thought it was over the fact that he'd insisted on a full-sized model instead of a compact, but it turned out to be something different.

"Did you hear what that clerk said?" Karl asked with a touch of exasperation.

Joe thought a moment, but nothing remarkable came to him, so he only shook his head.

Without waiting for his companion's reaction, Karl went on, "Unlimited *free* mileage. I do wish people would be more circumspect about the use of that word."

"What word?"

"Free! Free! The mileage is not free."

"Oh, she's probably never had a course in economics and besides, the fact remains that the marginal cost of an extra mile driven is zero although we have to purchase the gas."

"Nonetheless, the truth of the matter ought to be obvious to everyone," Karl observed. "A certain amount of mileage is assumed in the determination of the rates. As a consequence, light users pay too much and heavy users pay too little. It's just another example of the nonuser paying for the user."

"We'll be sure to put a lot of miles on our car." Joe suggested.

But Karl only frowned in response. "It's the principle of the thing, you know," he shot back at his friend. But then, something else diverted Karl's attention from this subject. "Uh, Joe," he began cautiously, "are you certain you want to drive? You recall what happened when we were vacationing in the Bahamas."

"I don't care what the policeman said, I still contend there was no one-way sign where we turned onto that street."

“But, nonetheless—”

Karl’s protest was too late, however, for Joe quickly unlocked the car and got in the driver’s seat. Then he said, “Besides, I spent a good hour last night studying a map of the area. You wouldn’t know where we’re going.”

Karl was still uneasy and, as they drove out of the lot, he said, “I could drive and you could navigate. That might work even better if you know the route so well.” This proposal got no response at all from Birnoff, but then, a few moments later, something caught Karl’s eye that made him even more concerned about his friend’s driving. “Joe,” he asked, “are you sure you even know how to get out of the hotel compound?”

“It’s quite simple. There’s only one way in and one way out. And the road just circles the hotel.”

“That explains why we just passed the rental car return sign again.”

“Oh, that. I was just testing your sense of direction,” Joe laughed. Then, after a darting glance from side to side, he swerved right at the next turnoff which, fortuitously, proved to lead to the exit from the resort grounds.

Some time later, after what Karl judged a surprisingly small number of false turns, they reached the Gulf-side beach at Clearwater. There they crossed the first bridge to the string of islands that paralleled the coast. “This ought to be particularly scenic,” Joe explained. “We’re now on an interconnected chain of islands that runs along the intercoastal waterway for perhaps twenty miles or so. Sand Key, the island with the hotel’s cabana club, is part of this chain. I thought we’d drive south down these islands toward St. Petersburg to get a view of the major resort areas. Then we can take another bridge back over to the mainland—at any of several points. I marked a couple of local restaurants on the map. We’ll probably be in the area of one or another of them in time for lunch.”

“I suppose it’s pleasant enough,” Karl agreed. “But all these scenic views begin to look alike to me after a while. Besides, I thought we might want to chat a little about the next revisions of our textbook, now that we have some quiet time together.”

Joe was suspicious. “I thought we were both pretty happy with the way things stood after the last revision. Except for the inevitable

need to bring a few statistics up to date here and there, and maybe to keep our economic policy chapters current."

"That's just what I had in mind. I thought we ought to revise our macroeconomic material a bit."

"I thought we had finally reached agreement on that. You recall how our editor loved my new introduction: that discussion about the responsibility of contemporary government, in the area of the 'positive state' or simply 'big government,' if you want to use the more pejorative term, to ensure steady economic growth and ameliorate recessions. After that, it seems to me we treat the alternative policy approaches to that goal quite fairly. There's certainly as much monetarism and new classical theory in there as I can tolerate, and I know you feel the same way about the Keynesian material. Or, as we agreed to call it, the post-Keynesian material. And, if I can toot my own horn, I especially like my new, expanded discussion of how, after incorporating rational expectations into the Keynesian approach, the manipulation of short term governmental fiscal policy can impact aggregate demand and hence the GDP. You must admit that I really put some life in those issues."

"Watch out for that kid on his bicycle," Karl warned. "Maybe I shouldn't have raised this topic when you're driving, but well, what you just said is precisely the problem. It's precisely because you expanded the Keynesian explanation so much that I think we need to draw some sharper distinctions between short and long run effects. Your literary 'gems' apply to the short run, if at all. And that's if with a capital I. We need to better explain the supply-side and new classical views and their implications on the long run."

"The present discussion seems sufficient to me."

"Who's surprised?" Karl reacted. "You Keynesians—and let's just drop the *post*-or *neo*- or whatever qualifiers you'd like to show how you've gone beyond old John Maynard when in reality you haven't—you Keynesians only want to talk about the effects of fiscal policy on demand and on GDP. You always ignore the long run effects on supply and downplay the crowding-out argument."

"It seems only fair. You monetarists and your camp-following supply-siders and new classicists don't think fiscal policy has any long-term effect anyway. Just as long as you could keep your precious supply of money growing at a stable rate. If only macroeconomic policy could be that simple!"

"Say, are you about to turn here?" Karl had suddenly realized that his friend had, in his typically last-second fashion, decided to move into the left turn lane at a traffic light.

"I thought we'd cross back to the mainland here at Bellaire Causeway. It's a short-cut back to the hotel."

"But that sign we just passed said this'll be a toll bridge. Aren't there any free ones?"

Joe frowned and said, "Yes, but they're further along, well past the hotel."

"Skip the short-cut. We can take in a little more of this quote-free-unquote drive you were touting, and then we'll take a free bridge, as well. And don't complain. After all, I didn't when you rented this big car rather than a compact."

"Oh, *touché*," Joe conceded. Then he awkwardly worked his way out of the left turn lane, to the consternation of the other drivers around him.

Unnoticed to either of the car's occupants, a patrol car had pulled behind theirs attracted by Joe's erratic driving. Between Joe's cursory study of the map, their joint indecision, and the tone of their debate the vehicle weaved alternately between lanes. If cell phones were considered a potential distraction to drivers, then their debates qualified as absolute disruptions.

"Now where was I," Karl wondered out loud. "Oh, yes, I'm amazed that you poor holdovers from Depression-era, Keynesian economic theory don't feel lonely these days, given the number of both academic and governmental camp-followers, as you put it, that have been swayed otherwise by the likes of monetarists, supply siders and now new classical economists."

"There are still those of us who believe that short terms swings in the business cycle can be addressed by appropriate fiscal actions!" Joe shot back. "Besides, misguided thinking is misguided thinking, regardless of whether it's preached by three or thirty-three schools of thought."

The patrol car, still eluding the professor's attention, cruised no more than two car lengths behind. The officer had to exercise care as Joe accelerated and slowed in cadence with the intensity of their argument.

"So you'd deny that the frequent manipulation of fiscal policy to attempt, and I emphasize the word *attempt*, to fine tune the economy, à

la John Maynard—and I'll set aside for the moment the question of whether public officials even have the strength of will to ignore their other spending and taxing objectives to concentrate on stabilization goals—you'd deny that such manipulation creates tax incentives that have devastating effects on production over the long term?"

Joe frowned and said, "The beneficial effects of short term fiscal policy on aggregate demand far outweigh any possible adverse incentives of the taxes, if there are any in the first place."

Now it was Karl's turn to react. He threw up his hands and blew out a big breath of air in mock disgust. "Oh, my. You Keynesian hangers-on have always taught your students that an extra dollar spent by the government—whether from borrowing or taxing—increases short run GDP. But can't you see this instruction ignores the fact that government expenditures crowd out private ones?"

"There is scant evidence that the resultant deficits adversely affect real interest rates and during the interim the economy enjoys the stimulus effect of government tax and expenditure policy," Joe rebutted.

"Now you sound like the *Wall Street Journal* editorial writers claiming that deficits have no appreciable effect on real interest rates. What unlikely bedfellows, you and that 'not exactly' bastion of activist economic policy!" Karl extorted.

"Now wait just a minute," Joe blurted. "The *Journal* only argues that position because it believes that creating huge deficits by 'simulative' tax cuts is the only way to reign in federal government spending. Admitting that deficits could raise real interest rates would undercut their position."

"Besides," Joe continued, "part of the tax revenues that are ultimately collected to pay for the requisite government expenditures comes from what people would have saved."

"And what others would have invested!" Karl responded with increasing exasperation.

"You must admit, going back to your own argument a moment ago about how many people are in your camp today, that Keynesian policy continues to enjoy considerable support from a lot of influential people and has so for quite a long time."

"Even if that were true once who's surprised? It offers a perfect rationale for every politician with a pet spending project. They can claim that their projects would help raise the GDP and, thus, would help the entire nation, not just their state or district."



By this time, the officer had turned on her flashing blue light signaling Joe to pull over. But signaling as a form of information transfer breaks down whenever the receptor is disengaged. After following for a while and getting no response from Joe, the officer started to sound her siren when Joe pulled to a stop at a traffic light. The officer pulled her car immediately behind the professors', stepped out and walked determinedly toward Joe's driver side window. Just as the officer reached Joe's window and raised her hand to rap on the window, the light changed and off shot Joe leaving the officer with an incredulous look on her face and her hand poised in mid-air.

"But you forget the reverse side of Keynesian policy, the dampening effect it has on too-rapid growth during periods of inflation." Joe countered.

"Ha! And why is it that to achieve that dampening we always had to have a tax increase instead of a spending decrease?"

Joe shrugged as if the answer were obvious. "It's simply easier to change taxes than to alter government programs in midstream." Then

he added, "Oh, by the way, there's a sign for a free bridge. I'm going to turn here. Now there's no telling where we'll have to eat lunch."

"You and your stomach! But you're not getting away with changing the subject to food. Easier to change taxes, my foot! Let's be more precise. What you mean is that it's politically easier. All those politicians are afraid to cut the pork-barrel spending that they think is so crucial to getting re-elected. By-the-by, this is where dear old John Maynard really blew it. Imagine he criticized Classical theory for relying on the flexibility of wages and prices to restore high employment when in his view no such flexibility exists. So what did Keynes rely on? Flexible and responsive government spending. Just exactly when was the last time you saw federal spending go down?"

"Never mind the difficulty in reducing federal spending. The objective, after all, is to fight short-term cyclical swings. Does it really matter which mechanism you use?"

"You bet it does! Now, back to my point about the crowding-out effect," Karl said.

"Your hypothesis," Joe corrected. "I've yet to see a convincing empirical demonstration of those effects."

"What literature have you been reading lately? The plethora of recent research suggests that government deficits do result in higher real rates of interest. Once more, that same literature also finds that the reduced national saving generated by the deficits directly affects domestic investment and capital flows from abroad."

"And furthermore," Karl continued, "you certainly can't deny that politicians mostly ignore the long run for the apparent short-term 'quick fix.' And I emphasize the apparent character of those short-run changes in tax rates because their proponents inevitably ignore the adverse long-run consequences they have on people's incentives to produce and business incentives to invest."

Now Joe was getting equally excited. "Those long-run supply-side effects are way overblown—there's no evidence that past tax policy has had any significant adverse disincentive effects."

"What about the Laffer Curve³ point that increasing tax rates, once you're over the hump of the curve, actually will decrease tax revenues because of the effect on incentives and tax compliance?"

"Oh, yes. The famous curve first drawn on a paper napkin. It's certainly worth the paper it was written on."

"That's not fair. You know—"

"That there's no evidence that the nation was over the hump of the Laffer Curve in its tax policy."

"And why is it, then," Karl demanded, "that after the Russians replaced their progressive income tax, with a maximum rate of 30 percent, with a flat tax 13 percent that government revenues rose dramatically in the two years immediately following?"

Seemingly in response to this question, Joe jerked his head in surprise. But then he said, "Speaking of rising, isn't this bridge a bit steep?"

"And what are those bells and sirens for? Joe, watch out!"



The receptionist at the Bellevue was smiling and shaking her head as she returned from her coffee break. Seeing another clerk behind the desk, she laughed and said, "Tommie, I've just heard the funniest story on the radio. It seems these two college professors were out for a drive on the beaches. They were having a big argument, and they got so caught up in it they weren't watching where they were going."

"So, did they drive into the surf, or what?" the impatient Tommie asked.

"No, it was worse—or better, actually—than that. They'd turned at Madeira Beach to cross the bridge back to the mainland. But the driver was so engrossed in the argument that he ignored the red light and the fact that the drawbridge had started to go up. They drove right under the barricade as it was coming down. Then the front wheels of the car went over the edge of the bridge and they were stuck there."

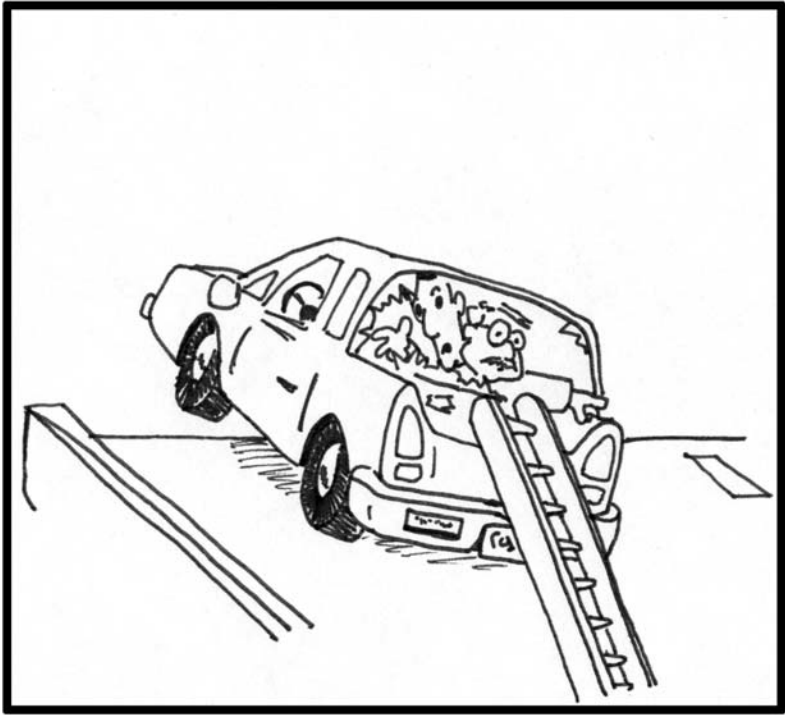
"Amazing!" Tommie agreed.

"Yeah. And they were balanced so precariously that the bridge tender was afraid to lower the bridge. He had to call the fire department, and they had to break out the car's back window and take the professors out on a fire ladder."

"Maybe there should be a law," Tommie laughed, "that these intellectual types should have to stick to bicycles."

Not long after this conversation Karl and Joe arrived back at the hotel—in a taxi. The two men, grimly silent, looking a bit tattered and tousled, and evidently a bit angry at each other, collected their keys and started for their rooms. But they were accosted by a bellhop who had been searching the hotel for them for most of the afternoon.

"Oh, Professor Teasdale. Professor Birnoff," the young man hailed from behind them.



But when the two men turned in response, the bellhop was taken about by their disheveled attire and their near-angry stares. "Wha what happened?" he stammered.

"We've been having an argument," Karl replied archly, as if the explanation for their appearance should be obvious.

"A discussion," Joe corrected.

"Er who won?" The boy asked.

Joe cast a sheepish glance at his friend and said, "I suppose you could say we reached a draw. Now, what was it you wanted?"

"Oh, right. That Detective Parker from the Sheriff's Department. He wants to see you both."