Chapter 1

Why Study the Economy?

Learning Objectives

1.1 Explain how the concept of well-being has been redefined to focus on capabilities.
1.2 Define an economy and economic institutions.
1.3 List three major economic indicators used to measure economic well-being for an economy as a whole.
1.4 Summarize three ways that the economic pie is distributed.

Well-being is central to the mission of social workers, other human services professionals, and many other occupations. In explaining why someone might want to be a social worker, the National Association of Social Workers (NASW, n.d.) webpage "Why Choose the Social Work Profession" states: "The primary mission of the social work profession is to enhance human well-being and help meet basic and complex needs of all people, with a particular focus on those who are vulnerable, oppressed, and living in poverty" (para. 1). Social work practice is often grounded in a *person-in-environment* framework. This phrase signals that each individual and their behavior is shaped by their context. This important context includes the individual's economic situation: their access to important economic resources, their level of economic functioning, and the health of the economy overall.

Learning about the ways economic well-being—or the lack of well-being—shape people's lives will assist you with both providing direct services to individuals and addressing their environment through public policy advocacy. Here are examples of how economic literacy can help with your work:

- You are working with a teenager who is acting out at school. You learn that there is a lot of stress at home. Even though two parents are working, their work hours and take-home pay are unstable from week to week. Their paychecks do not stretch far enough to cover essentials. The parents blame themselves and each other for their financial instability. As you work with the family, you have the perspective to understand how their situation reflects a common squeeze affecting many families struggling to pay bills: rising prices for housing, child care, and health care combined with income stagnation. You use this understanding of the teenager's economic environment to address the counterproductive cycle of blame and anger that is affecting family dynamics.

- You are collaborating with local activists on proposed legislation to raise the state minimum wage and to mandate paid sick leave. A skeptical member of the state legislature assures you that they understand economics. They claim that these regulations would cause unemployment by increasing the cost of hiring workers and that you would just be hurting the people you want to help. You help your group construct a response that draws on empirical evidence about the costs and benefits of such policies.
- You need to document to one of your organization's funders that economic trends are driving up demand for your services. To do this, you need data about national and local trends in poverty and unemployment. It would also be useful to present these statistics by race and gender to reflect the populations you serve. Fortunately, you know where to find this information and how to use it to argue for increased funding.
- You and your colleagues are advocating that your city reallocate budget priorities toward more emergency mental health services. These services are needed to alleviate the use of police in situations in which trained social workers would be more appropriate. Your contribution is explaining why mental health services (in addition to police protection) are a public good that benefit the community as a whole.
- You are in charge of submitting a program budget for next year. You need an estimate of how much program costs are likely to increase based on the inflation rate. You also need to estimate an appropriate cost-of-living increase for your staff. Your supervisor is impressed when you back up your budget request with relevant government data.

Being prepared to include economic data in program projections and funding proposals, to comment on local public policy initiatives that impact economic well-being, and to appreciate the economic challenges faced by clients are all important aspects of your work.

Familiarity with economic concepts and theory can help anyone—in any field—who wants to follow the news, decide how to vote, invest for their future well-being, or take control of their lives as consumers and workers. We (you and the textbook authors) are all part of the economy. We all have contributions to make to the economic well-being of our communities. We all make decisions about how we conduct our economic lives based on our values and preferences. Abhijit Banerjee and Esther Duflo, winners of the 2019 Nobel Prize in Economics (and married partners), end their book *Good Economics for Hard Times* by saying, "Economics is too important to be left to economists"; instead, they maintain, "It is for all of us who want a better, saner, more humane world" (Banerjee & Duflo, 2019, p. 326).

This textbook is written especially for people who are studying for careers that involve working with the public, such as social work and other human services professions, as well as for those who are already working in these fields. Our structure for this book is based on a course we have taught for more than 20 years. In 1999, Deb Figart created a new course called "Economics of Social Welfare" at Stockton University. Both of us have taught the course, which was designed to meet a curricular requirement for BSW students. The course focuses on the topics that are most relevant for human services professionals. The course also serves many students studying health sciences, social sciences, environmental sustainability, and teacher education.

This textbook is not watered-down economics. Ask any of our hundreds of students over the past two decades. We want you to learn about real, cutting-edge, modern economics with direct applications and examples. The book still has graphs and numbers, such as percentages, but they are included only as needed. We also are upfront with you about places where economists disagree and when simple economic models do not tell the full story. We, the authors, consider ourselves pluralists when it comes to economic theory. *Pluralism* is a commitment to understanding diverse theories, drawing on their strengths while noting their weaknesses. We believe it is important to have a full tool kit when it comes to theory rather than to rely solely on one theory or framework to answer every question.

This introductory chapter seeks to deepen your understanding of what is meant by "economic well-being." We introduce you to what an economy is, including some of the key institutions that organize economic life in the United States today. The chapter discusses the kinds of statistics that are used to evaluate whether an economy is meeting the objective of maintaining and enhancing well-being. The concepts in this chapter will ground you in the perspectives that are developed throughout the rest of the book.

1.1 Achieving Well-Being

Well-being is not simply happiness or satisfaction (Rath & Harter, 2010). In recent years, the study of well-being has shifted focus. Well-being used to be viewed as mainly a psychological state—that is, how people feel about their lives. The problem is that people can psychologically adapt to terrible circumstances, so just asking them how they feel may not give you a reliable answer. For example, someone experiencing domestic abuse or addiction may report satisfaction with their life. If you think of well-being as a state of mind, then increasing someone's well-being could be merely a matter of improving their attitude or acclimating them to hardship. Such a strategy does not address the underlying context shaping their behavior.

More recently, **well-being** has been redefined to focus on whether or not someone has the ability to fulfill their goals (Nussbaum, 2011). Asking this question has two advantages. First, it allows some value neutrality in terms of what those goals are. Goals may vary by individual preferences, culture, norms, or historical period. The second advantage is that it draws our attention to external barriers and supports. Someone living in poverty may be happy. Their poverty, however, still presents barriers to various goals, so poverty is an obstacle to the achievement of well-being. An economy with a large percentage of its population in poverty is not meeting the goal of economic well-being.

WELL-BEING capability to fulfill one's goals

When you look at well-being through this lens, it is clear why understanding economics is so important to human services practitioners. Our economic lives play a critical role in our ability to achieve our goals. The Council on Social Work Education (CSWE), the organization that sets curricular standards, created an Economic Well-Being Clearinghouse to stress the importance of integrating economics into the social work curriculum. The CSWE (n.d.) described economic well-being as follows:

> *Economic well-being* is defined as having present and future financial security. . . .
>
> Economic well-being may be achieved by individuals, families, and communities through public policies that ensure the ability to build financial knowledge and skills, access to safe and affordable financial products and economic resources, and opportunities for generating income and asset-building. It occurs within a context of economic justice within which labor markets provide opportunities for secure full-employment with adequate compensation and benefits for all. (paras. 1–2)

Providing more details, the Clearinghouse indicated that economic well-being includes consistency in meeting basic needs, control over one's finances, having economic choices, and feelings of security and personal fulfillment.

Some social scientists have distilled recent insights regarding well-being into a related concept: *capabilities*, which means having the capacity to do or to be that which you value. The two pioneers of the study of capabilities are economist Amartya Sen (1999) and political philosopher Martha Nussbaum (2011). Sen argued that the most important aspect of well-being is a person's ability to function, but that functioning must involve meaningful choices. He contrasted someone who is starving with someone who is fasting. These two people do not have the same level of well-being—the same set of capabilities—even though both are hungry. The difference lies in their ability to choose whether or not to eat (Sen, 1999). Choosing to fast as a spiritual practice or a political statement is different than not being able to afford food. A life in which someone has meaningful choices allows them to flourish. *Flourishing* is another way of describing well-being.

Focusing on building people's capabilities emphasizes what is called *positive freedom*, the ability to do things that you value. You are probably more used to thinking about freedom *from* rather than freedom *to*. *Negative freedom* is freedom *from* interference. So, for example, minimum wage laws can be viewed as violating someone's freedom. Such regulations restrict an employer and an employee *from* agreeing to a labor contract at a wage below the legal floor. On the other hand, minimum wage laws ensure that full-time workers earn a minimally acceptable standard of living for that society. In this view, minimum wages enhance the ability *to* meet one's goals, especially the ability to nourish oneself and be healthy. The policy enhances positive freedom by promoting self-determination and agency. Many contemporary political debates revolve around the tension between positive and negative freedom.

It is through economic activity that people access much of the material resources, care, and meaningful pursuits that contribute to well-being. Through economic activity, people nourish their bodies and give their bodies shelter. An economy determines how people access health care, education, and recreation. People engage in work, care for their families, and pursue other purposeful activities as part of their economic lives. Good societies, including good economies and good governments, develop people's well-being. Good societies help people flourish.

1.2 Defining an Economy

Before studying economics, students often associate the subject with money. However, economies have existed long before currency became commonplace. Instead, it is more helpful to start with the activity of provisioning. *Provisioning* refers to the process of obtaining the resources and assets that one needs to function effectively. When you think of economic activity as focused on securing provisions, you might initially envision basic needs, such as food, clothing, and shelter. But, of course, people provide for many other needs and wants through their economic activity—everything from cell phones to haircuts to streetlights to child care. Provisioning is a social process. No one is self-sufficient, and humans have always interacted with others to provision for themselves, their families, and their communities. More importantly, how people provision differs by historical and cultural context. **Economy** is the word used to describe how a society organizes **social provisioning** (Gruchy, 1987; Power, 2016). An *economy* is a system within the larger society.

ECONOMY system of institutions that organizes social provisioning

SOCIAL PROVISIONING process of obtaining the resources and assets that one needs to function effectively

In today's economy, you might buy tomatoes at a big-box store, a grocery store, the local bodega, or a farmer's market. Or you can pick up your cell phone and order groceries (tomatoes included) to be delivered to your door. You may grow your own tomatoes as a leisure activity. Or your neighbor or coworker might gift you some from their garden. If you are facing hard times, you might visit a food bank for tomatoes and other provisions. Or you might live in a food desert, where most of your provisions are canned or boxed from a dollar store.

Purchased tomatoes might have been grown on a small family farm that treats its pickers ethically. But it is more likely that their production was organized by a global agribusiness company using cheap migrant labor to keep costs down. Perhaps, though, they were grown in Immokalee, Florida, the winter fresh tomato capital of the United States. If so, you likely purchased them from a supermarket that signed onto a Fair Food Agreement with the Coalition of Immokalee Workers, guaranteeing that the tomatoes were sourced from growers who adhere to human rights standards, including paying higher wages.* All of these ways of cultivating and distributing tomatoes are part of our complex economic system.

Despite the complexity and variety of economic activities—even this simple example of provisioning tomatoes—the pieces come together into a system that is labeled an "economy." An economy consists of interrelated **institutions** that shape our economic behavior (Mayhew, 2018). These economic institutions evolve and change over time. Yet the process of change is slow because institutions can become so normalized that people do not stop to ask where they came from. Economic institutions come to be seen as inevitable rather than as social constructions.

INSTITUTIONS human-constructed organizations, laws, rules, habits, and social norms that evolve over time

The best way to explain the definition of institutions is through examples. The practice of exchanging money for goods and services is an institution, as is the expectation that U.S. restaurant servers are partially paid by customers via tips. While shaking hands to close a deal is a habit in some cultures, formal contracts are another institution for abiding to agreements. Laws that establish private property and police

*These agreements are monitored by the Fair Foods Standards Council, a nongovernmental organization. The Coalition of Immokalee Workers has expanded beyond Florida to other states and Mexico. See https://ciw-online.org/ for a description of their work.

departments charged with enforcing these laws are institutions. Another example is the Equal Pay Act of 1963 (P.L. 88-38), which makes it illegal to pay men and women differently if they do the same work at the same workplace. Enacting this law meant rejecting the preexisting norm that men deserved higher pay because they were considered breadwinners, and women were not (Figart et al., 2002). Until the late 1960s, it was a social norm for job ads, usually in newspapers, to be organized into two sections: "Help Wanted: Male" and "Help Wanted: Female." Employers predetermined the sex of the person they intended to hire when they wrote the advertisement. In response to the movement for gender equity, some newspapers changed this institutionalized practice even before it was formally outlawed by a court ruling in 1973 (Pedriana & Abraham, 2006).

The tax deduction for mortgage interest is an institution that helped spur home ownership among the middle class in the late 20th century. At the same time, bank lending practices supported by federal policy adhered to a practice called *redlining* that denied loans (and the wealth creation of investing in property) to African American communities (Darity & Mullen, 2020). The U.S. norm since World War II has been to link health insurance to employment by offering it as a benefit, whereas most developed countries primarily rely on government (and taxes) to fund health insurance or healthcare services.

All of these institutions are parts of the system that structures how people provision for themselves and enhance their economic well-being. In particular, economists focus on four key institutions, examining their behavior within our economic system: (1) *households* in which people organize their provisioning strategies as well as produce and consume;* (2) private sector *businesses* that provide goods and services in exchange for money; (3) *governments* at the federal, state, and local levels that shape the rules for economic behavior and provide some goods and services (among other functions); and (4) *nonprofit organizations* that provide goods and services to advance a public purpose rather than for profit. All four play important roles in economic life.

Economists, however, tend to start with the buying and selling behavior of households and businesses. The name they give to the way contemporary society structures these interactions is **markets**. The term "markets" draws on the metaphor of physical places where people buy and sell things, such as a farmers' market. These kinds of physical gathering places for selling goods have a long history. The economic concept of a market extends the meaning to include any kind of interaction between buyers and sellers facilitated by money. This definition is more abstract. Markets are an economic institution. Chapter 3 explains how they structure important aspects of

*"Households" is a broader term than "families." It includes people who live alone and people living with those who are not related to them by blood or marriage. Social scientists study both households and families.

economic life. Chapter 4 turns to the different, yet equally important, functions that government and nonprofits play in advancing economic well-being.

MARKETS processes whereby buyers and sellers interact to exchange money for commodities

1.3 Measuring Economic Well-Being

The previous sections defined the goal of an economy as enhancing well-being. To assess whether an economy is meeting this goal, economists use *economic indicators* to measure the economy's performance; indicators are like the lights and gauges on a car dashboard that measure how a car is performing. If the tire pressure falls below a specified level, a warning light is triggered. You just see the light, but the car's computer has been regularly calculating tire pressure and comparing it with some programmed threshold. The speedometer tells you how fast you are driving, and you can assess for yourself how that compares with the appropriate speed for wherever you are driving.

Economic well-being, however, is challenging to measure. How would you come up with a number or a set of numbers to assess whether an economy is enhancing people's capabilities? This is a project that economists started taking much more seriously during the Great Depression of the 1930s. It was clear that the economies of the United States and Europe were doing terribly, but it wasn't clear how badly. Policymakers also wanted a way to assess whether the New Deal programs of President Franklin D. Roosevelt (in office 1933–1945) were helping (see chapter 7). The mid-20th century economists who honed our system of economic statistics did not use the term "well-being." Their focus was narrower and influenced by the pressing economic issues of the day. The goal they tended to focus on was rising **living standards**. This narrower focus on people's material standard of living often shapes economic policy more than the broader idea of well-being.

LIVING STANDARDS necessities, comforts, and luxuries available a group of people in a geographic area

Economists operationalized this goal of rising living standards by posing three quantitative questions: (1) Are there enough jobs for those who want them? (2) Are prices rising fast enough for businesses to be profitable but not so fast that consumers cannot afford to buy things? and (3) Is the economy growing so that more goods and services are available to the population? These questions focus on the whole economy of a nation or geographic area. They provide a big picture of how an economy is performing. Economists call this **macroeconomics**. These three questions can be distilled into three macroeconomic goals, covered in Part II of this textbook. The three macroeconomic goals are

1. full employment, measured by the unemployment rate;
2. price stability, measured by the inflation rate; and
3. economic growth, measured by Gross Domestic Product (GDP).

MACROECONOMICS branch of economics that focuses on the whole economy of a nation or geographic area

In reviewing these economic goals and indicators, the three chapters in Part II examine the strengths and limits of the relevant indicator in capturing well-being. Indicators are imperfect. Unemployment statistics, for example, tell us whether there are jobs for people who want them. But they tell us much less about job quality. Price stability is helpful for households trying to make ends meet. But if wages—the price for labor—are also stagnant, people may still be financially squeezed. Economic growth means more goods and services are being produced and consumed. However, an economy can grow by using scarce natural resources or polluting the environment and then paying people to clean it up. People's well-being can be sacrificed if growth increases because they work long hours or in dangerous conditions.

Notice that we have not mentioned the stock market as an indicator of well-being. In the news, you will hear daily or even hourly updates about changes in stock prices. It would be natural to assume that economists spend a lot of time focused on stock market indicators like the Dow Jones Industrial Average. Stock prices matter, and some economists study them, but they are not among the most important economic indicators. Why not? Stocks do not play a large role in most people's living standards, as discussed in chapter 11. The benefits of rising stock prices are concentrated in a few hands. There are better numbers to watch to understand how an economy—and the people who live in that economy—are doing. The primary focus in this text is the factors that contribute to the economic functioning of households and families.

1.4 Distributing the Economic Pie

The three macroeconomic measures of overall performance tell us whether the macroeconomy—the economy as a whole—is healthy. This is only part of the story. A growing economy does not mean that all members of society are experiencing rising living standards. Many of the issues confronted by human services professionals are affected by the distribution of the economic pie. Income and wealth are the primary way people access the goods and services produced through economic growth.

In recent decades, the economic benefits of growth have largely gone to those who already have substantial income and wealth (Boushey, 2019b).

Economies rely on three key economic distribution mechanisms: (1) exchange, (2) redistribution, and (3) reciprocity. *Exchange* refers to transactions in which one thing of value is traded for another. It is generally synchronous. Distribution via market exchanges is based on the ability to pay (as discussed in chapter 3). If the exchange is voluntary, it is often assumed that both parties feel they would be better off after the trade. This is not always the case. Power imbalances and the human need for sustenance can constrain individuals' freedom to walk away from a transaction. The justice or fairness of an exchange can be evaluated using a commutative justice principle. *Commutative justice* requires that an exchange be equal or equitable. The challenge is to decide the appropriate metric for equality: satisfaction, price, social value, or some other measure.

Economists spend a lot of time studying and theorizing about market exchanges. Indeed, this is the primary subject in microeconomics. **Microeconomics** focuses on market conditions and prices for specific goods and services. In capitalism, this includes the market for labor. Wages are the prices paid for different types of labor. And wages are how most people earn their income. Many other forms of income, such as profits from a business, capital gains from stock sales, or rent from property, also come from market transactions. Government regulations and the legal system set the institutional context surrounding this private sector activity. For example, local governments inspect restaurants to ensure they are abiding by health codes and enforce building codes to ensure construction projects meet safety standards.

MICROECONOMICS branch of economics that focuses on market conditions and prices for goods and services

Redistribution, also a subject studied in microeconomics, refers to a transfer of income, assets, resources, or goods and services among individuals or groups. Robin Hood, who notoriously robbed the rich and gave to the poor in 12th century England, was engaging in redistribution—as is a family that shares food, shelter, and other goods and services among its members, even with children who do not bring home a paycheck. Redistribution among households, in a democratic society, is generally initiated by government. In contemporary economies, we associate it with redistributive social welfare and social insurance policies enacted to achieve greater equity or financial security. Government, for example, requires employers and employees to pay into a state-managed unemployment compensation fund. Those who qualify for benefits when they lose their job are paid out of these funds, redistributing income. Temporary Assistance for Needy Families (TANF) is another income replacement program funded by the federal and state governments.

Redistribution, though, is much broader than the social safety net. Governments at the federal, state, and local levels directly provide residents with a wide range of goods and services that contribute to living standards and well-being: K–12 education, student loans, roads and highways, military protection and national security, basic medical and scientific research, weather forecasts, public housing, parks and playgrounds, sanitation services, Medicare and Medicaid health insurance, and veterans' services, to name a few. Taxes and other revenue sources help fund these public goods and services. All of these government activities result in a form of redistribution, as there is not a strict accounting that equalizes contributions and rewards. For example, so-called red states typically tend to utilize more federal resources than they contribute, and so-called blue states are among the net givers to the federal government (Rockefeller Institute of Government, 2021).

Reciprocity is different than exchange or redistribution. Reciprocity focuses on mutual benefit but not necessarily through a simultaneous exchange. In ancient tribal societies, someone in the group with extra meat (that would quickly spoil without refrigeration) shared it with others, knowing that someday they would be fed when another hunter was successful. In 19th century rural U.S. communities, neighbors would all pitch in to "raise" a new barn, following social norms of reciprocity. In a system of generalized reciprocity, being indebted to other people was the normal state of affairs. It held societies together.

People still incorporate reciprocity into their lives. The neighbors who share their tomato harvest do not expect you to pay them. They do not make you sign a contract to help them at a future date. But you are now connected and might invite them to a barbeque, help them shovel their snow, or water their plants when they go out of town. Their motivation is the creation of this bond, rather than pure calculation that they want you to owe them something. Yet there is often some expectation of balance. If you buy a friend a birthday gift for several years in a row and they never reciprocate, at some point you will probably stop the practice of gift-giving. Such social norms make reciprocity different than *altruism*, which is selfless concern with others' well-being.

Part III of the text focuses on distributional issues that are critical to social work practice: income and wealth inequality, economic disparities by race and gender, and poverty. The chapters cover several indicators of income inequality, race and gender wage differentials, alternative poverty measures, and food insecurity rates. Here, too, there are challenges in defining measurable goals and targets. Some income inequality is necessary in an economy that relies on markets to distribute goods and services. Our economic system is based on the idea that people need material incentives to work hard, develop new innovations, and invest in risky ventures. On the other hand, too much inequality and poverty can have the opposite effect, squashing people's aspirations. If those income hierarchies also reflect entrenched racial and gender disparities, an economy is wasting the potential contributions of segments of the population. And, because middle-class households spend most of their incomes, a strong middle class with the purchasing power to buy products produced by businesses provides an engine for economic growth.

Summing Up

An economy is a system of institutions that organizes social provisioning. These systems produce and distribute the resources and assets that people need to function effectively. This textbook explores the ways that the U.S. economy succeeds and the ways that it fails at enhancing people's capacity to function effectively and their ability to flourish. Along the way, you will learn why economists, political leaders, and others sometimes disagree about how to promote economic well-being. You will hopefully develop clearer and well-defended positions on economic issues. And you can harness your economic knowledge to impact the world for yourself and others. No less important, you will develop skills in economic analysis that will help you provide direct services, support the administrative structures that provide such services, and/or influence policy.

The rest of Part I examines the key institutions that shape the contemporary economy. Chapter 2 provides historical background on how the U.S. economy and the discipline of economics evolved to their current form. Chapter 3 presents the supply and demand model that most economists utilize to depict how businesses interact with households (consumers). Chapter 4 details the significant role of government as an economic institution as well as nonprofit organizations. All of these institutions are essential parts of the system that structures how people in the United States provision for themselves and enhance their economic well-being. Part II of the book focuses on the macroeconomic performance of the nation as a whole. Part III addresses distributional issues, a topic within microeconomics. Part IV contains two chapters examining economic policies to improve economic functioning.

Chapters 2 through 11 contain contributions called "Voices from the Field." These short reflections by people with human services backgrounds illustrate how their work impacts or is impacted by the economy.

Critical Thinking Questions

- How does each of the three macroeconomic goals—full employment, price stability, and economic growth—contribute to economic well-being? Is there one that seems particularly important? Is there another important goal for the economy as a whole that you think should be added to the list?

- Think of an example of each of the three distribution mechanisms in your own economic activity. How do you rely on exchange, redistribution, and reciprocity to increase your economic well-being?

Resources

The Grand Challenges for Social Work (see https://grandchallengesforsocialwork.org/), a project of the American Academy of Social Work and Social Welfare, aims to "champion social progress powered by science" (para. 1). Initiated in 2016, the project identified 13 social challenges in three major areas: (1) improving individual and family well-being, (2) building a stronger social fabric, and (3) creating a just society.