

# MICROECONOMICS



**HEINZ KOHLER**

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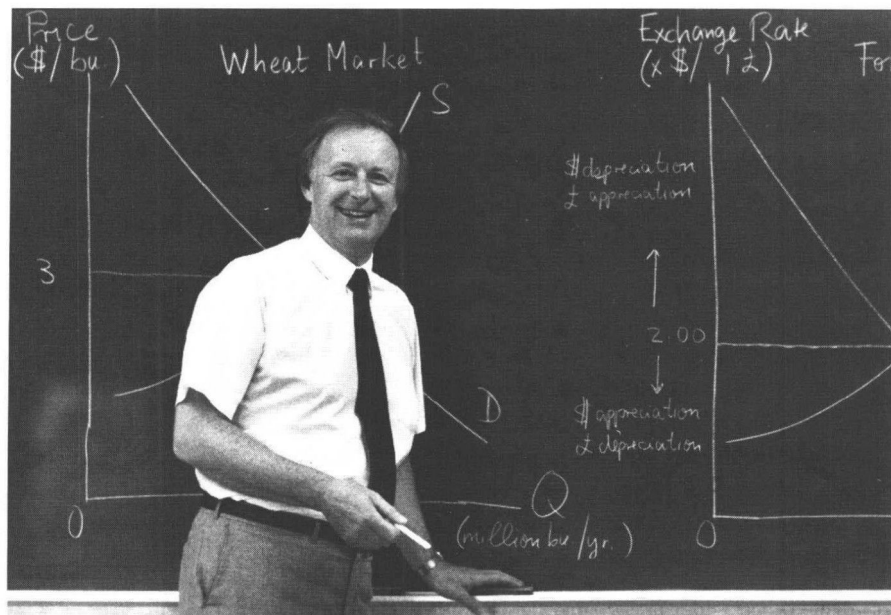
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## ABOUT THE AUTHOR

**Heinz Kohler**, the Willard L. Thorp Professor of Economics at Amherst College, received his undergraduate education from the Free University of Berlin, Germany, and his M.A. and Ph.D. from the University of Michigan. Professor Kohler has taught at Amherst College for thirty years. Besides teaching principles each year, Professor Kohler has systematically rotated through the upper level courses, in order to stay "fresh" as well as up to date. Additionally, he has taught part-time at the University of Massachusetts, Amherst for nearly twenty years. He has written many successful texts: *Intermediate Microeconomics* (3d ed.), *Statistics for Business and Economics* (2d ed.), *Essentials of Statistics*, *Comparative Economic Systems*, and *Welfare and Planning: An Analysis of Capitalism vs. Socialism*.

# PREFACE

Economics is an important subject. Those who master the theoretical knowledge of the discipline can wield a powerful set of tools capable of explaining why people act the way they do and capable of affecting—for better or worse—the lives of millions around the world. However, as practitioners of economics know all too well, the crucial theoretical core of the discipline is far from fixed. It is enlarged each year by a vast amount of newly published research. Typically this new material appears in a mathematical garb that is inaccessible to the beginner. What makes economics remarkable and what accounts for the writing of this book is the fact that the latest theoretical advances can be written up in an intuitive manner and presented in basic textbooks. This fact alone not only justifies but indeed dictates the publication of new principles of economics texts.

Economics is also an exciting subject. This fact is evidenced throughout this text by a continual link between theory and applications. Such is the case with principal-agent issues that lead to discussions of corporate raiders, takeover battles, and general problems of economic incentives. This is also the case with hundreds of other subjects, ranging from comparable worth to logrolling, from price discrimination to pollution rights, and from persuasive advertising to prisoners' dilemma games. Close to a hundred other applications, on the other hand, have been set off as self-contained boxed examples. Consider just some of the topics: Airwave Wars and Tonga Satellites; Banning Trade to Save the Elephant; The Guiding Hand of MITI; The Internationalization of the Beer Brewing Industry; Producing Cheaper Computers: The Caribbean Connection; The Lure of Venezuela's "Liquid Coal"; Broadway

and the Bottom Line; Challenging Airfone's Monopoly; The Convergence of Bank Credit Cards; The Proliferation of Fragrances; The Coming Global Labor Market; Pinups at Work Are Sexual Harassment; Selling Football Teams; The Homeless; Antitrust in a Global Economy; Green Marketing; Computer Software—a Public Good; The Welfare Trap.

## To the Instructor

As noted above, this text aims to introduce the beginning student to the most up-to-date theoretical knowledge that economists possess. It also illustrates the usefulness of economic theory with a wealth of applications. But there is more. Having taught economic principles continuously for over thirty years, I know that too many texts race too quickly through the important ideas in economics. As a result—year in, year out—students stumble on the same set of concepts. Most chapters of this text, therefore, contain *caution boxes* that identify the common traps into which students often fall. Additionally, special "Ideas in History" sections provide valuable perspectives on how the theoretical tools of modern-day economists were fashioned and by whom. The more than a dozen such boxes focus on such topics as The Division of Labor, The Proper Economic Role of Government, The Theory of Comparative Advantage, The Marginalist Revolution, and The Nature of the Firm; the list goes on.

Most important, perhaps, is another feature still. The trend in new (and revised) principles of economics texts is to recognize the international setting of a single economy (like the American one) and integrate various international vignettes throughout the text. This text takes the "interna-

tional evolution" a step further by covering such topics as comparative advantage, the strategic trade model, and exchange rate theory early in the text (in Chapter 4) and then integrating the use of these ideas throughout.

While it has long been customary to relegate the discussion of international trade to a last chapter in the introductory text, the appearance of the topic early on in this text signals an important change: Unlike some decades ago, present-day American consumers, workers, and business managers operate in markets that are essentially international. More and more products that *consumers* buy are made abroad or are produced by foreign firms located on American soil. Given the collapse of communism in Eastern Europe, the economic unification of Western Europe, the imminent creation of a North American free trade zone, and an easing of immigration policies around the world, *workers* will find themselves increasingly in an international labor market as well. And *business managers* have long adjusted to trading products and financial capital alike in an international setting. For all these reasons and more, decision makers must operate in a global setting; it is only proper that all the chapters of this book take account of this new reality.

The book is divided into five parts. Part I, Basic Concepts, introduces scarcity, choice, and optimizing (Chapter 1); the nature of economic systems and how economists theorize about them (Chapter 2); the fundamentals of demand and supply (Chapter 3); and the important role of international trade in boosting the wealth of nations (Chapter 4).

Part II, Households and Firms, introduces consumer preferences and demand (Chapter 5); elasticity (Chapter 6); the nature of the firm, including principal-agent issues, takeover battles, and the like (Chapter 7); the technology of production (Chapter 8); and the costs of production (Chapter 9).

Part III, Markets for Goods, covers perfect competition (Chapter 10), monopoly and cartels (Chapter 11), and oligopoly and monopolistic competition (Chapter 12).

Part IV, Markets for Resources, deals with perfectly competitive labor markets (Chapter 13), imperfectly competitive labor markets (Chapter 14), markets for natural and capital resources (Chapter

15), the personal distribution of income and the problem of poverty (Chapter 16).

Part V, Government in the Microeconomy, explores the role of government in greater depth than earlier discussions of price fixing, excise taxes, and labor market laws allowed. This final section of the text addresses antitrust policy (Chapter 17), economic and social regulation (Chapter 18), externalities and environmental economics (Chapter 19), public goods and public choices (Chapter 20), and the redistribution of income (Chapter 21). For those who wish to explore the economics of health, an optional chapter is offered in the *Student Workbook* that accompanies this text.

Numerous support items have been designed to help the instructor. Some of these are built into the back of the book—a complete Glossary of key concepts and Solutions to Odd-Numbered Chapter Questions and Problems. In addition, there are a number of Appendices: the use of graphs in economics (Chapter 1a); indifference curve analysis (Chapter 5a); major concepts of business accounting (Chapter 7a); and isoquant analysis (Chapter 8a). Other support items—all written by the author of the text—include an *Instructor's Manual*, a *Test Bank*, a *Student Workbook*, and the MICEC personal computer programs. The *Instructor's Manual* contains Answers to the even-numbered end-of-chapter Questions and Problems in the text as well as various teaching suggestions. The *Test Bank* contains 75 multiple-choice questions for each text chapter (not duplicated in the *Student Workbook* described in the next section). The MICEC diskette contains numerous exercises described below.

## To the Student

This text comes with a number of study aids designed to make your work easier and more successful than it would otherwise be. Some of these aids are built into the text. Consider the chapter summaries, end-of-chapter listings of Key Concepts (boldfaced in the text), end-of-chapter Questions and Problems, Solutions to odd-numbered items at the back of the book, and a complete Glossary of all the key concepts. More important, perhaps, a separate *Student Workbook* is also available. For each chapter of the text, it contains 35 multiple-choice

questions, 12 true-false questions, and a number of problems—along with detailed solutions and answers to all of these. In addition, you will find a listing of Selected Readings if you want to pursue any given topic further than the text. The *Workbook* also contains an optional chapter, The Economics of Health Care. Finally, note the availability of MICEC, a personal computer diskette filled with numerous exercises on key topics throughout the text.

### The MICEC Personal Computer Programs

A set of programs for IBM personal computers and compatible machines has been specially designed to accompany this text. The computer must have graphics capability and DOS version 2.1 or later. The 10 programs cover the following aspects of the text:

1. Demand and Supply
2. The Production Function
3. Costs
4. Profit-Maximization: Perfect Competition
5. Profit-Maximization: Imperfect Competition
6. Labor Markets
7. Capital Budgeting
8. Regulation
9. Externalities
10. Public Goods

The programs include about 350 graphical and tabular exercises on the subjects noted above, as well as mathematical programs to work out compounding, discounting, and net present value problems.

### Initial Start-Up Procedure

Given the DOS prompt, such as `A>`, place the diskette into the computer and type:

**A:MICEC**

Then press the *Enter* key. Naturally, if you have placed the diskette into another drive (such as **B**), replace the **A** above by a different appropriate letter (such as **B**).

### Hard Disk Installation Instructions

Instructions on how to install the programs on a computer hard disk are provided on the diskette itself. Simply follow the start-up procedure noted above, and you will find the instructions.

### Acknowledgments

I would like to express my sincere gratitude to many who have helped me in the creation of this text. Many reviewers, listed below, took time to examine at least a portion of the text and gave me good advice. Often I took it; to the extent that I did not, only I am to blame.

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Heinz Kohler  
Willard L. Thorp Professor of Economics  
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