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THE ECONOMY TODAY

BRADLEY R. SCHILLER

THE ECONOMY TODAY

Tenth Edition

BRADLEY R. SCHILLER

American University



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THE ECONOMY TODAY

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ABOUT THE AUTHOR

Bradley R. Schiller has over three decades of experience teaching introductory economics at American University, the University of California (Berkeley and Santa Cruz), and the University of Maryland. He has given guest lectures at more than 300 colleges ranging from Fresno, California, to Istanbul, Turkey. Dr. Schiller's unique contribution to teaching is his ability to relate basic principles to current socioeconomic problems, institutions, and public policy decisions. This perspective is evident throughout *The Economy Today*.

Dr. Schiller derives this policy focus from his extensive experience as a Washington consultant. He has been a consultant to most major federal agencies, many congressional committees, and political candidates. In addition, he has evaluated scores of government programs and helped design others. His studies of discrimination, training programs, tax reform, pensions, welfare, Social Security, and lifetime wage patterns have appeared in both professional journals and popular media. Dr. Schiller is also a frequent commentator on economic policy for television, radio, and newspapers.

Dr. Schiller received his Ph.D. from Harvard in 1969. He earned a B.A. degree, with great distinction, from the University of California (Berkeley) in 1965. He is now a professor of economics in the School of Public Affairs at American University in Washington, D.C.

THE 24/7 ECONOMY

24/7. That's the way the economy works. While you're sleeping, workers at the Texas Instrument plant in Kuala Lumpur are assembling the electronic circuits that will instruct your alarm clock to go off, relay the news via satellite TV or radio, enable video presentations in class or at remote locations, and help retrieve music files on the iPod you carry around. Venezuelan oil workers are pumping oil that will fuel your drive to class. Ethiopian farmers are harvesting the coffee beans that will help keep you alert. Traders in London, Hong Kong, and Tokyo are pushing the value of the dollar up or down, changing the cost of travel and trade. In an increasingly globalized economy, the economy truly never sleeps. It's in motion 24 hours a day, 7 days a week.

All of this perpetual motion makes teaching economics increasingly difficult. The parameters of the economy are constantly changing. Interest rates are up one day, down the next. The same with oil prices. Inflation looks worrisome one month and benign the next. Job growth looks great one month, then dismal the next. Even such famous prognosticators as Alan Greenspan have trouble keeping track of all these (changing) data, much less divining the implied direction of the economy.

At the micro level, incessant changes in the economy create similar problems. Market structures are continuously evolving. Products are always changing. With those changes, even market boundaries are on the move. Is your local cable franchise really a monopoly when satellite and Internet companies offer virtually identical products? Will Apple Computer, Inc., with a 70 percent market share in the portable MP3-player market, behave more like a monopolist or like a perfect competitor? With the Internet creating *global* shopping malls, how should industry concentration ratios be calculated? The Federal Trade Commission and the Antitrust Division of the U.S. Justice Department are vexed by ever-changing market boundaries and structures.

Coping with Change

So how do we cope with all this flux in the classroom? Or, for that matter, in a textbook that will be in print for three years? We could ignore the complexities of the real world and focus exclusively on abstract principles, perhaps "enlivening" the presentation with fables about the Acme Widget Company or the Jack and Jill Water Company. That approach not only bores students, but it also solidifies the misperception that economics is irrelevant to their daily life. Alternatively, we could spend countless hours reporting and discussing the economic news of the day. But that approach transforms the principles course into a current-events symposium.

The Economy Today pursues a different strategy. I am convinced that economics is an exciting and very relevant field of study. I have felt this way since I attended my first undergraduate principles course. Despite an overbearing, boring textbook and a super-sized class (over 1,000 students!), I somehow discerned that economics could be an interesting topic. All it needed was a commitment to merging theoretical insights with the daily realities of shopping malls, stock markets, global integration, and policy development. Whew!

What Makes Economies Tick

How does this lofty ambition translate into the nuts and bolts of teaching? It starts by infusing the textbook and the course with a purposeful theme. Spotlighting scarcity and the necessity for choice is not enough; there's a much bigger picture. It's really about why some nations prosper while others languish. As we look around the world, how can we explain why millionaires abound in the United States, Hong Kong, the United Kingdom, and Australia, while 2.8 *billion* earthlings live on less than \$2 a day? How is it that affluent consumers in developed nations carry around videophones while one-fourth of the world's population has never made a phone call? Surely, the

way an economy is structured has something to do with this. At the micro level, Adam Smith taught us long ago that the degree of competition in product markets affects the quantity, quality, and price of consumer products.

At the aggregate level, we've also seen that macro structure matters. Specifically, we recognize that the degree of government intervention in an economy is a critical determinant of its performance. The Chinese Communist Party once thought that central control of an economy would not only reduce inequalities but also accelerate growth. Since decentralizing parts of its economy, freeing up some markets, and even legalizing private property (see World View, p. 17), China has become the world's fastest-growing economy. India has heeded China's experience and is also pursuing a massive privatization and deregulation strategy (World View, p. 11).

This doesn't imply that *laissez faire* is the answer to all of our economic problems. What it does emphasize, however, is how important the choice between market reliance and government dependence can be.

We know that the three core questions in economics are WHAT, HOW, and FOR WHOM to produce. Instead of discussing them in a political and institutional void, we should energize these issues with more real-world context. We should also ask who should resolve these core questions, the governments or the marketplace? Where, when, and why do we expect market failure—suboptimal answers to the WHAT, HOW, and FOR WHOM questions. Where, when, and why can we expect government intervention to give us better answers—or to fail? This theme of market reliance versus government dependence runs through every chapter of *The Economy Today*.

Within the two-dimensional framework of three core questions and markets-versus-governments decision making, *The Economy Today* pursues basic principles in an unwavering real-world context. The commitment to relevance is evident from the get-go. At the outset, the very serious trade-offs between arms spending and food production in North Korea (pp. 8–9) put the concept of opportunity costs into a meaningful context. Chapter 1 pursues the nature of opportunity cost into the future by examining the earthbound sacrifices we'll have to make for the proposed Lunar and Martian settlements (Chapter 1's "Economy Tomorrow" section, pp. 19–20). These kinds of concrete, page-one examples motivate students to learn *and retain* core economic principles.

Chapter 2 gives students a quick economic tour of the world. It shows how different nations have resolved the WHAT, HOW, and FOR WHOM questions. Students see how rich the USA is—and how poor other nations are (see World Views, pp. 28 and 29). They also see that inequality is not an ailment unique to "rich" nations (e.g., World View, p. 41). This chapter gives students an empirically based global perspective on economic outcomes that can spark a motivated search for explanations, that is, economic theory.

In macro, we emphasize the cyclical problems of unemployment and inflation. But students don't get motivated to learn the origins or solutions for these problems just by citing the latest economics statistics (yawn). Most students don't have enough personal experience to know why 6 percent unemployment or 3.7 percent inflation are *serious* concerns. To fill that void, *The Economy Today* takes students on a tour of unemployment and inflation. In Chapter 6, they see unemployment statistics translate into personal tragedies and social tensions. They see who loses their job when the unemployment rate rises (p. 118) and how devastating the experience can be (pp. 121–122). In Chapter 7, the devastation wrought by hyperinflation drives home the realization that price-level changes matter. These two chapters lay a global, historical, and personal foundation that gives purpose to the study of macro theory. Few other texts lay this foundation.

Markets vs. Government

Real-World Concerns

Macro Realities

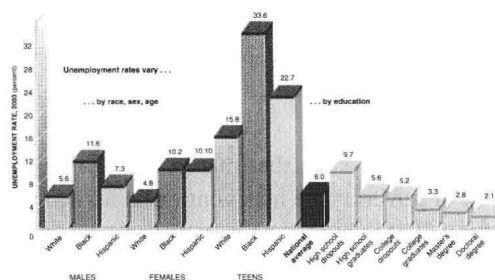


FIGURE 6-4
Unemployment isn't Experienced Equally by Race, Sex, or Education
Minority groups, teenagers, and less-educated individuals experience higher rates of unemployment. Teenage unemployment rates are particularly high, especially for black and other minority youth.
Source: U.S. Department of Labor (2003 data).

In the core macro chapters (8–18), *The Economy Today* constantly reminds students of the real-world relevancy of core concepts. The potential instability of aggregate demand, for example, is illustrated with data on quarterly variance in consumption and investment (p. 192) as well as News accounts on investment decisions (p. 191) and consumer confidence (pp. 187, 219). The impacts of terrorism (News, p. 191) and “oil shocks” (News, p. 337) on both AD and AS get timely recognition, as do the successive tax cuts of 2001, 2002, 2003, and 2004. By tying core AS/AD concepts to real-world events, the textbook highlights the importance and relevance of macro theory.

When we peer into the long run, it's important to ask what makes economies grow and what institutions or policies can accelerate that growth. But students won't pay much attention until you demonstrate that economic growth is both *important* and *desirable*. Chapter 17 attempts this by reviewing the payoffs to growth and by directly confronting concerns about the limits to growth.

Nowhere is the commitment to a real-world context more evident than in Chapter 19. The very title of the chapter (“Theory vs. Reality”) reveals its purpose. The chapter not only confronts but also *explains* the gap between the promise of macro theory and the reality of economic outcomes. The section entitled “Why Things Don't Always Work” (pp. 397–408) is a nice bridge between the blackboard and the boardroom for your students. Every macro course should include this chapter.

Micro Realities

The emphasis on real-world applications continues in the micro section. Nowhere is this more evident than in the discussion of market structure. Chapter 22 offers the typical depiction of the perfectly competitive firm in static equilibrium (albeit illustrated with real-world catfish farmers). Then comes a *second* chapter on perfect competition which turns the spotlight on the competitive dynamics that power market-based economies. The reality of market structures is that they typically evolve—sometimes at lightening speed. In 1977, Apple Computer, Inc., had a virtual monopoly on personal computers; in 2001 it had a lock on portable, digital music players (iPods). In both cases, a swarm of wannabes transformed the market into more competitive structures. In the process, the products improved, sales volumes increased, and prices fell at extraordinary rates of speed. By emphasizing the *behavior* of a competitive market rather than just the *structure* of static equilibrium, Chapter 23 injects excitement into the discussion of market structures. The “Economy Tomorrow” section at the end of Chapter 23 explains why iPods are likely to cost only \$49 within a few years. Understanding how competitive markets make this happen is probably the most important insight in microeconomics. By building on student experience with music downloads and MP3 players, *The Economy Today* helps students acquire that insight.

The central theme of government dependence versus market reliance is particularly evident in Chapter 27, “(De)Regulation.” When the lights went out in California and later in the Midwest, a lot of people blamed “power pirates.” They wanted the government to more closely regulate electricity markets. Others protested that government regulation (e.g., price controls, environmental standards) had *caused* the brownouts and blackouts. They advocated *less* government intervention and more reliance on the

market mechanism. Chapter 27 uses the experience of (de)regulation in the rail, air, electricity, and telecommunications industries to highlight unique features of natural monopoly and the possibilities of both market and government failure.

The FOR WHOM question is one of the three core issues in economics, but it typically gets scant treatment in a principles course. *The Economy Today* tries to remedy this shortfall with companion chapters on taxes (Chapter 33) and income transfers (34). The chapters emphasize the key economic concepts (e.g., marginal tax rates, tax elasticity of labor supply, moral hazard) that are common to both sides of the tax-transfer redistribution system. By examining President George W. Bush's 2003 tax return (p. 700) students see the distinction between nominal and effective tax rates. By reviewing trends in aging and labor-force participation (pp. 716–721), they may realize how Social Security alters work incentives and behavior.

International chapters (35 and 36) not only explain the core concepts of comparative advantage and exchange-rate determination but also assess the *resistance* to free trade and flexible exchange rates. By identifying the vested interests that resist trade, *The Economy Today* bridges the gap between free-trade models and real-world trade disputes. Students see not only why trade is desirable but also how and why we pay for trade barriers. This is a lot more interesting than simply reciting the mathematics of comparative advantage in cloth and wine.

The bottom line here is simple and straight forward: *by infusing the presentation of core concepts with a unifying theme and pervasive real-world application*, *The Economy Today* offers an exciting and motivated introduction to economics. As the accompanying News confirms, this is the kind of reality-based instruction today's students want.

International Realities

IN THE NEWS

Real World 101

Colleges Scramble to Serve Students Looking for Classes That Elucidate Current Events

Who knew that the University of Nebraska houses American academia's only Afghanistan studies center? Or that a top-notch geography department would put Southwest Texas State University in San Marcos on the map for CIA recruiters? Before September 11, such specialties attracted scant attention

and few students. But the speed with which colleges nationwide have raced to accommodate the stampede of undergraduates suddenly interested in war-related subject areas has stunned even seasoned educators (and turned scores into celebrity-experts).

—Mary Lord

Source: *U.S. News & World Report*, November 5, 2001. Reprinted with permission. www.usnews.com

Analysis: Real-world events and issues spark student interest in academic courses. No text brings the real world into the economics course as much as *The Economy Today*.

EFFECTIVE PEDAGOGY

Despite the abundance of real-world applications, this is at heart a *principles* text, not a compendium of issues. Good theory and interesting applications are not mutually exclusive. This is a text that wants to *teach economics*, not just increase awareness of policy issues. To that end, *The Economy Today* provides a logically organized and uncluttered theoretical structure for macro, micro, and international theory. What distinguishes this text from others on the market is that it conveys theory in a lively, student-friendly manner.

Clean, Clear Theory

Concept Reinforcement

Self-Explanatory
Graphs and Tables

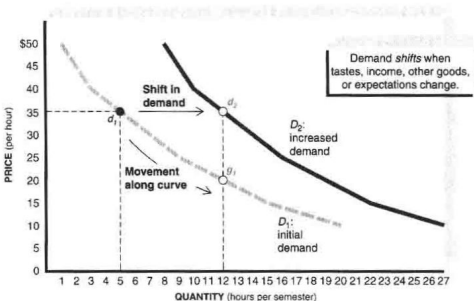
Student comprehension of core theory is facilitated with careful, consistent, and effective pedagogy. This distinctive pedagogy includes the following features:

Graphs are *completely* labeled, colorful, and positioned on background grids. Because students often enter the principles course as graph-phobics, graphs are frequently accompanied by synchronized tabular data. Every table is also annotated. This shouldn't be a product-differentiating feature but, sadly, it is. Putting a table in a textbook without an annotation is akin to writing a cluster of numbers on the board, then leaving the classroom without any explanation.

FIGURE 3.3
Shifts vs. Movements

A demand curve shows how a consumer responds to price changes. If the determinants of demand stay constant, the response is a *movement* along the curve to a new quantity demanded. In this case, the quantity demanded increases from 5 (point d_1) to 12 (point g_1), when price falls from \$35 to \$20 per hour.

If the determinants of demand change, the entire demand curve *shifts*. In this case, an increase in income increases demand. With more income, Tom is willing to buy 12 hours at the initial price of \$35 (point d_2), not just the 5 hours he demanded before the lottery win.



		Quantity Demanded (hours per semester)	
Price (per hour)		Initial Demand	After Increase in Income
A	\$50	1	8
B	45	2	9
C	40	3	10
D	35	5	12
E	30	7	14
F	25	9	16
G	20	12	19
H	15	15	22
I	10	20	27

Reinforced Key
Concepts

Key terms are defined in the margin when they first appear and, unlike in other texts, redefined as necessary in subsequent chapters. Web site references are directly tied to the book's content, not hung on like ornaments. End-of-chapter discussion questions use tables, graphs, and boxed news stories from the text, reinforcing key concepts.

Boxed and Annotated
Applications

In addition to the real-world applications that run through the body of the text, *The Economy Today* intersperses boxed domestic (In the News) and global (World View) case studies. Although nearly every text on the market now offers boxed applications, *The Economy Today's* presentation is distinctive. First, the sheer number of In the News (130) and World View (70) boxes is unique. Second, and more important, *every* boxed application is referenced in the body of the text. Third, *every* News and World View comes with a brief, self-contained explanation. Fourth, the News and World View boxes are the subject of the end-of-chapter Discussion Questions and Student Problem Set exercises. In combination, these distinctive features assure that students will actually read the boxed applications and discern their economic content. The *Test Bank* and *DiscoverEcon with Paul Solman videos* also provide subsets of questions tied to the News and World View boxes so that instructors can confirm student use of this feature.

Photos and Cartoons

The text presentation is also enlivened with occasional photos and cartoons that reflect basic concepts. The photos on page 40 are much more vivid testimony to the extremes of inequality than the data in Figure 2.6 (p. 39). The contrasting photos of the original Apple I (p. 500) and the iMac (p. 509) underscore how the "animal spirits" of competitive markets spur innovation. The cartoon on page x reminds students that not all economists are of the same mind. Every photo and cartoon is annotated and referenced in the body of the text. These visual features are an integral part of the presentation, not diversions.



© Alan Schen Photography/CORBIS



© Wolfgang Spunberg/Photo Edit

Analysis: The market distributes income (and, in turn, goods and services) according to the resources an individual owns and how well they are used. If the resulting inequalities are too great, some redistribution via government intervention may be desired.

The one adjective invariably used to describe *The Economy Today* is “readable.” Professors often express a bit of shock when they realize that students actually enjoy reading the book. (Well, not as much as a Stephen King novel, but a whole lot better than most textbooks they’ve had to plow through.) The writing style is lively and issue-focused. Unlike any other textbook on the market, every boxed feature, every graph, every table, and every cartoon is explained and analyzed. Every feature is also referenced in the text, so students actually learn the material rather than skipping over it. Because readability is ultimately in the eye of the beholder, you might ask a couple of students to read and compare an analogous chapter in *The Economy Today* and in another text. This is a test *The Economy Today* usually wins.

I firmly believe that students must *work* with key concepts in order to really learn them. Weekly homework assignments are *de rigueur* in my own classes. To facilitate homework assignments, I have prepared the *Student Problem Set*, which includes built-in numerical and graphing problems that build on the tables, graphs, and boxed material in each chapter. Grids for drawing graphs are also provided. Each chapter’s problem set is detachable and includes answer boxes that facilitate grading. (Answers are available in the *Instructor’s Resource Manual*, in print, or in downloadable form on the book’s Web site). The *Student Problem Set* is behind the tab at the end of this book.

All of these pedagogical features add up to an unusually supportive learning context for students. With this support, students will learn and retain more economic concepts—and maybe even enjoy the educational process.

DISTINCTIVE MACRO

The macro section of *The Economy Today* is well-known for its balanced presentation of different theoretical perspectives, its consistent use of the AS/AD framework, its global perspective, and its explicit juxtaposition of theory and reality.

This isn’t a highly opinionated text. It doesn’t assert that only long-run issues matter or that monetary policy is the only effective lever of short-run stabilization. Rather, *The Economy Today* strives to offer students a *balanced* introduction to both short- and long-run macro concerns as well as an array of competing viewpoints. Keynes isn’t dead, nor are supply-side policy options ignored. Instead, competing theories are presented in their best possible light, and then subjected to comparative scrutiny. This approach reflects my belief that students need to be exposed to a variety of perspectives if they’re to understand the range and intensity of ongoing debates. Maybe we

Readability

Student Problem Set

Balanced Macro Theory

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