



# GEOMORPHICS

*THIRD  
CANADIAN  
EDITION*

*ROY VOGT  
EDWIN G. DOLAN*

# PRINCIPLES OF ECONOMICS

*THIRD  
CANADIAN  
EDITION*

*ROY VOGT  
EDWIN G. DOLAN*

*HOLT, RINEHART AND WINSTON OF CANADA, LIMITED  
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# P R E F A C E

The last decade has been a productive one for the economics profession. Economists have gained a better understanding both of the world at large and of their own discipline. In macroeconomics, more is known about the dynamics of inflation and unemployment, the role of monetary policy, the determinants of unemployment, the role of expectations in shaping economic behaviour, and the interaction between the domestic economy and the world economy. In microeconomics, such fields of study as regulation, competition policy, human resources, and income distribution have taken on a new life.

Our understanding of the Canadian economy has been enhanced by the *Royal Commission on the Economic Union and Development Prospects in Canada* (1985), known more popularly as the Macdonald Royal Commission. Its numerous research studies form the basis of many of the revisions made in the third edition of this text.

But at the same time that progress has been made, events have posed new questions. Economists continue to disagree on such matters as the effects of the federal deficit, the proper path for monetary policy, the consequences of corporate takeovers, and the reasons for differences in men's and women's average pay, to name just a few areas of controversy.

Both the rapid pace at which economic knowledge has advanced and the continuing controversies make teaching economics a challenge. Meeting the challenge requires a special kind of textbook. First, it requires a book that brings the latest theoretical developments into the classroom and explains them as clearly as it explains established topics such as supply and demand. And second, it requires a book that emphasizes the tools that all economists use, the common ways of thinking that they employ even when they reach different conclusions.

The following pages outline the strategy used in this book to meet the challenges of teaching economics as we move from the 1980s into the 1990s.

## Overview

### Introduction

The book begins with a set of chapters that provide an overview of economics and the economy. The first chapter surveys the subject matter of economics and gives an idea of what economists do. Chapter 2 looks at the central problems faced by every economy. Chapter 3 provides an introduction to supply-and-demand analysis. The final chapter in the introductory section explores the role of business and government in the economy. As a group, these four chapters focus on the essentials required as background for both macro- and microeconomics. After finishing this section, the student is equipped for either a macro- or a micro-first sequence.

### Macroeconomics

The crucial first step in learning macroeconomics is to get a picture of how the parts of the economy fit together into a whole.

Two chapters serve that purpose in this book. Chapter 5 uses the framework of the circular flow to show how firms, households, units of government, and the rest of the world interact.

Chapter 6 completes the overview with a discussion of national income accounting.

Having established a framework for analysis, the text moves on to monetary and fiscal policy. Chapters 7–13 explore institutions, theory, and issues in an integrated manner. Emphasis is placed on the fact that tools of monetary and fiscal policy allow the government, within reasonable limits, to control the growth of nominal GDP—that is of GDP measured in current dollars.

Chapters 14–15 then turn to the topics of inflation, unemployment, and economic growth. The aggregate real supply and demand framework is used to show how changes in monetary and fiscal policy affect real variables. The issues of long-run versus short-run effects, of the role of expectations, of the fiscal-monetary policy mix, and of alternatives to current policies are all explored.

### Microeconomics

The traditional core of microeconomics is presented in Chapters 16–22. These chapters give a careful exposition of the theories of consumer behaviour, production, cost, perfect competition, monopoly, and other market structures.

The next group of chapters explore issues in the relationship of government to business. Chapter 23 and 24 cover competition policy and regulation. Chapter 25 deals with the impact of foreign

investment on business behaviour in Canada. Following these comes a section of three chapters (26–28) on factor markets, including a chapter on poverty and income distribution.

### The World Economy

Much of the text focusses on the Canadian economy. The final two chapters provide a broader perspective. Chapter 29 deals with problems of economic development in various parts of the world. Finally, Chapter 30 looks at the economy of the Soviet Union and other socialist economies as examples of resource allocation in nonmarket systems.

## Teaching and Learning Aids in the Text

In order for a textbook to work in the classroom, it must not only contain the proper subject matter but also provide an effective set of teaching and learning aids. The teaching and learning aids in this book include the following.

### Case studies

According to a time-honoured principle, each generalization should receive a specific illustration and each illustration should lead to a generalization. Following this principle, case studies are used in a variety of ways throughout the book. First, each chapter opens with a short case study striking a key theme. Second, boxed cases are used to illustrate important points in each chapter. And third, many chapters include a case for discussion, with questions, as part of the material at the end of the chapter.

### Readability

In this book readability means three things. First, it means a lively writing style that draws students into the subject matter. Second, it means complete control of the level of difficulty, as measured by standard readability formulas. And third, it means elimination of the “alphabet soup” style used in many texts. When terms such as *average variable cost* and *marginal propensity to consume* occur, the text uses the actual words, not a thicket of AVCs and MPCs that bewilder students.

### Vocabulary

For many students vocabulary is one of the big stumbling blocks to learning economics. This book uses a four-level reinforcement technique to handle the problem. First, each new term is printed



in boldface where it is first used and defined. Second, the term and its definition appear on the same page in the margin. Third, a list of new terms is given at the end of the chapter. And fourth, a complete alphabetical glossary of terms appears at the end of the book.

### Graphs

For the benefit of students who may not be used to working with graphs, an appendix on the subject appears after Chapter 1. This appendix does more than just explain techniques. It also addresses the most common problems students have in working with graphs. One of these problems is the tendency to memorize graphs as meaningless patterns of lines. Another is the inability to draw original graphs when they are needed in note-taking or on examinations. The appendix warns of these pitfalls and explains how they can be avoided.

### Appendixes

In addition to the Chapter 1 appendix on working with graphs, appendixes are used at other points in the book to cover topics that some instructors like to include and others do not. Examples include appendixes on indifference curves and isoquants that follow Chapter 17 and 18. Three appendixes present algebraic statements of the arguments in the corresponding chapters.

### Chapter openings

The first page of each chapter is used to help orient the student to the chapter. A list of **learning objectives** appears first. (These are keyed both to the summary that appears at the end of the chapter and to the study guide.) Following this there is a list of **terms from previous chapters** that the student may find it useful to review. On the next page of each chapter, a **short case study** is presented to introduce the chapter.

### Chapter material

A number of learning aids appear at the end of each chapter. First there is a numbered **summary** that covers each of the main learning objectives of the chapter. This is followed by a set of short **questions for review**. The first question focuses on the new vocabulary terms introduced in the chapter, and the remaining ones are keyed to the chapter's learning objectives. Next there is a set of **problems and topics for discussion**. These give applications of topics covered in the chapter. They challenge the student to move beyond recall of the text, using graphic problems, projects

for library work, provocative questions on normative issues, and so on. In most chapters this section includes a **case for discussion** with a directed set of questions.

## The Package

This book is a part of a complete package of materials for teaching and learning economics. The text is accompanied by its own study guide, instructor's manual, test bank, and computerized test bank.

### Study guide

The study guide is the student's most important supplement to the text. Each chapter in the study guide is organized around the chapter's learning objectives. The learning objectives are followed by a **walking tour** of the chapter, which is a **programmed review** designed to reinforce the central concepts of the chapter. Then comes a set of **hands-on problems**, many of which emphasize the development of skill in using graphs. **Case studies** based on actual news items provide practice in real-world applications of economic theory. **Special boxes** warn against common mistakes. Finally, each chapter contains a **self-test** that presents items similar to those in the instructor's test bank. All problems and self-test questions are fully answered at the end of the study guide. The answer sections include graphs where appropriate, as well as explanations of right and wrong answers to self-test questions.

The study guide has been developed and written by Beverly Cameron, a user of the text at the University of Manitoba, with the result that the two items are fully compatible.

### Instructor's manual

Each instructor has his or her own unique approach to teaching economics. The instructor's manual is a tool that assists in integrating the instructor's style with the approach taken by the book. Each chapter begins with a section entitled "What's Different Here, and Why" that will assist in converting lecture notes that were written for different texts or earlier editions of this text. Answers to end-of-chapter questions from the text are also given, as well as the answers to application questions in the study guide. The manual also contains a Test Bank with more than 1000 multiple-choice questions, many of them newly developed for this edition.



**Interactive computer software**

A unique, new interactive computer software package, **EconoGraph**, was developed for Economics at the University of Delaware, one of the first schools to move into the new technology of learning by using computers in the classroom. **EconoGraph** is a set of floppy disks that contain tutorials on the most important areas of theory covered in the text. It features extensive diagnostics of right and wrong answers given by the user and unique interactive graphic exercises. It is available for the IBM PC and most compatibles with graphics card. A demonstration disk is available on request from your textbook representative.

**Changes in the Third Canadian Edition**

The third edition reflects the input of a great many users of the text at schools across the country. That input included formal and less formal feedback contributed via letter and telephone by users too numerous to list. In addition, the Canadian author benefited from the suggestions, comments, and even the mistakes of his own students at the University of Manitoba. Together with the help of several reviewers, the result was a very thorough revision.

**Introductory chapters**

Chapters 1 and 2 have been substantially reorganized and rewritten. Chapter 1 focusses on scarcity and choice as the central concepts of economics; it also surveys the subject matter of economics and gives an idea of what economists do. Chapter 2 is organized around the problems of what, how, and for whom, which must be solved by all economies. Chapter 4 has been completely rewritten, utilizing new material from the Macdonald Royal Commission.

**Macroeconomics**

The macroeconomics section begins, as before, with a chapter on the circular flow. Chapter 6, on national income accounting, incorporates the changeover from Gross National Income to Gross Domestic Income. Chapter 7, which introduces fiscal policy, has been thoroughly rewritten in the light of theoretical developments and policy controversies of recent years.

Monetary theory and policy has also been a rapidly developing field, necessitating a reorganization of Chapters 9 to 11. Chapter 9, which covers banking institutions, now also covers the process of deposit creation by chartered banks. Chapter 10, which covers the supply and demand for money, has been extensively rewritten. As

in earlier editions, Chapter 11 integrates fiscal and monetary theory. It also explores problems of coordinating monetary and fiscal policy. Interactions between domestic monetary policy and the foreign sector are described in Chapter 13, after a discussion of the foreign market in Chapter 12.

The chapters in Part III of the book have been reorganized. Chapter 14 applies aggregate real supply and demand analysis to problems of inflation, recession, and economic growth, using a more streamlined graphic presentation than in the second edition. Added topics include an appendix on the economics of rational expectations and one on Canada's unemployment figures. Chapter 15 is devoted to new alternatives for combatting the problems of inflation and unemployment.

### **Microeconomics**

The microeconomic theory chapters have received a thorough going-over, with numerous new examples and case studies added. User suggestions for additional explanation have been incorporated, for example, in the section on the production function in Chapter 18. Also in response to user suggestion, an appendix on isoquants has been added to Chapter 18.

Applications of microeconomics have been updated to reflect both recent research work and policy developments. Chapter 22 on entrepreneurship and competition has been greeted by reviewers as a fresh and practical revision of the previous chapter on monopolistic competition.

### **The world economy**

The last chapter of the book, "Capitalism versus Socialism," has been reorganized. It now includes a discussion of the Chinese economy and other recent changes in socialist economies.

### **A word or two of thanks**

We have been extremely fortunate in getting help of many kinds from many quarters while writing this book. It is a pleasure to acknowledge that help here.

The greatest debt is owed to Edwin G. Dolan and David E. Lindsey, authors of the U.S. version, who provided the theoretical inspiration and many of the technical details for the underlying macroeconomics model of this book.

Next we must thank the reviewers who commented on various drafts of the manuscript and suggested countless improvements. For the Canadian edition of *Economics*, the suggestions of Professor Avi Cohen of York University were especially detailed and helpful. Also working very closely with the development of this

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## **PUBLISHER'S NOTE TO INSTRUCTORS AND STUDENTS**

This textbook is a key component of your course. If you are the instructor of this course, you undoubtedly considered a number of texts carefully before choosing this as the one that will work best for your students and you. The authors and publishers of this book spent considerable time and money to ensure its high quality, and we appreciate your recognition of this effort and accomplishment.

If you are a student we are confident that this text will help you to meet the objectives of your course. You will also find it helpful after the course is finished as a valuable addition to your personal library. So hold on to it.

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And since we want to hear what you think about this book, please be sure to send us the stamped reply card at the end of the text. This will help us to continue publishing high-quality books for your courses.

Gratitude is again extended to Ruth Vogt, for unfailing support and encouragement—the kind of contribution the economics profession has found no way of measuring.

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