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Principles of Microeconomics



2nd Edition



Principles of Microeconomics

second edition

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Preface

The goal of this book is to present modern economics in a form that is intuitive, interesting, and useful for students who have had no prior exposure to this fascinating subject. When I took the introductory economics course in college way back in the 1960s, I found the course and the textbook (Paul Samuelson's) fascinating. People called 1960s-vintage economics the "new economics," because many new ideas, including those put forth by John Maynard Keynes, were being applied for the first time in public policy. But during the 1970s, the 1980s, and the 1990s, economics underwent another tremendous wave of change. Now at the end of the 20th century, economics places much greater emphasis on incentives, on expectations, on long-run fundamentals, on the use of experiments, on rich surveys of individual experiences, on the theory of institutions, and on the importance of stable, predictable economic policies. These new ideas are both interesting and of great relevance to individuals, to firms, and to governments as we start the 21st century. The world economy has also changed radically in the last thirty years with market economies now being the preferred choice of virtually all countries around the world and with billions of more people linked together through international trade. With these changes economics is now more fascinating and more relevant than ever.

JOINING THE OLD WITH THE NEW

My strategy in developing the first edition of the textbook, published three years ago, was to give these changes a prominent, clearly explained place alongside the older parts of economics and thereby to make modern economics—with all its fascination and relevance—available to beginning students. The enthusiastic reaction of teachers and students to the first edition has validated this strategy. Teachers who have successfully taught from the first edition point to the clear demonstrations of how a market economy actually works, to the thorough explanation of why markets are efficient when incentives are right and inefficient when incentives are wrong, to the emphasis on long-run fundamentals, to the lively analysis and discussion of real-world public policy, and perhaps most crucial—and certainly the most gratifying to me—to the clear, intuitive explanation of basic economic principles through analogy, example, and user-friendly graphs and illustrations.

DEVELOPING THE SECOND EDITION

My strategy in developing the second edition of the text was to produce a streamlined version of the first edition—with more efficient exposition, better organization, more visually effective page layouts, and with many new and updated real-world examples. Suggestions for the revision came from students in the introductory course I teach each year, from students and faculty who have used the book at many other colleges and universities, and from experts in specialized areas—such as experimental economics or international trade—whose advice we sought directly.

Armed with these suggestions we created a revised outline for the second edition. I then revisited every line of text, every graph, every box, every cartoon, and

every photo, adding, deleting, or rewriting to streamline, clarify, and update. After faculty reviews of this draft and, of course, more editing and rewriting, the manuscript moved into production, during which layout—the size and placement of text, tables, and graphs on the page—became my paramount concern. One of the advantages of modern computer page-making techniques is that I could interact in real time with the production editor, experimenting with different layouts and making sure, for example, that the descriptions of the graphs in the text were placed at the most helpful positions relative to the graphs themselves. Though most time-consuming, this interaction was invaluable for making a user-friendly, visually efficient layout.

Key Text Revisions: Streamlining, Updating, and Enhancing Intuition

A few examples of the changes I made in the second edition will show how the discussion was streamlined, made more intuitive, and updated. A detailed account of all the additions, deletions, and modifications is found in the transition guide in the Instructor's Resource Manual and on the web site (<http://www.hmco.com/college>).

Major streamlining was achieved, for example, by eliminating Chapter 14, which had previewed the role of government, and by integrating the material on public choice into the chapter on public goods and externalities (now Chapter 15). Other examples of improved organization include moving the material on the nature of firms from Chapter 8 to Chapter 6 (the first chapter on the theory of the firm) and moving some of the discussion of the role of government to Chapter 10 on monopoly so that instructors can discuss policy options before the more detailed treatment of antitrust and regulation in Chapter 16.

Examples of more intuitive explanations include the use of a new extended example of a student-run firm to derive the supply curve in Chapter 6. And by highlighting the analogy between the consumer decision in Chapter 5, and the firm decision in Chapter 6, the trio of Chapters 5, 6, and 7 (about which many faculty have been especially enthusiastic) now works better than ever. To make the double-auction market demonstration more useful to instructors (who may not have time to conduct experiments in class), we produced a short video to illustrate how experimental markets work.

New, Improved Boxes

As we revised, added, or updated boxes, we gave many of them special designations—"Reading the News About . . ." or "Using Economics to Explain . . ."—in order to help students use the material more effectively. Among the many new or revised boxes you'll find coverage of experimental results on the theory of taxation (Chapter 7) and the model of monopoly (Chapter 10), and helpful hints for drafting costs curves (Chapter 8); you'll also find Reading the News boxes about price floors (Chapter 3), labor supply decisions in the household (Chapter 12), stock price changes (Chapter 13), and the 1996 Welfare Reform Act (Chapter 14).

Enhanced Teaching and Learning Package

The package of teaching and learning aids (described below) has been completely revised with several new options. The teaching software has been expanded to match each chapter of the text. A web page is now available to provide additional help and information to both students and instructors. And a new series of teaching videos has been produced.

A BRIEF TOUR

Principles of Microeconomics is designed for a one-term course. Knowing that teachers use a great variety of sequences and syllabi, I have therefore taken great pains to allow for alternative plans of coverage. International economic issues are considered throughout the text, with separate chapters on international economic policy.

The basic workings of markets and the reasons they improve people's lives are the subjects of Part 1. Chapter 1 introduces the field of economics through a case study showing how economists observe and explain economic puzzles. Chapter 1 defines key terms and ideas, and Chapter 2 outlines the basic unifying themes of economics: scarcity, choice, and the production possibilities curve. The role of prices, the inherent international aspect of economics, the importance of property rights and incentives, and the difference between central planning and markets are some of the key ideas in these chapters. Chapters 3 and 4 cover the basic supply and demand model. I have tried to explain these basic ideas as fully and as clearly as I can, adding the extra sentence of clarification whenever it might help in understanding. The goal is to show how to use the supply and demand model and to learn to "think like an economist." A trio of chapters—5, 6, and 7—has the aim of explaining why competitive markets are efficient, perhaps the most important idea in economics. The parallel exposition of utility maximization (Chapter 5) and profit maximization (Chapter 6) culminates in a detailed description of why competitive markets are efficient (Chapter 7). These first seven chapters provide a complete, self-contained analysis of competitive markets before going on to develop more difficult concepts, such as long-run versus short-run cost curves or monopolist competition. This approach enables the student to learn, appreciate, and use important concepts such as efficiency and deadweight loss early in the course.

A modern market economy is not static; rather it grows and changes over time as firms add new and better machines and as people add to their skills and training. Part 2 describes how firms and markets grow and change over time. This part also shows how economists model the behavior of firms that are not perfectly competitive, such as monopolies. The models of dynamic behavior and imperfect competition developed here are used to explain the rise and fall of real-world firms and industries. Part 2 also delves into the special characteristics of labor markets.

Different countries have taken widely different approaches to the economy. The policy of some countries has been to intervene in virtually every economic decision; other countries have followed more hands-off policies. Part 3, therefore, is devoted to the role of government in the economy. Tax policy, welfare reform, environmental policy, international trade policy, the regulation of industry, and the role of government in producing public goods are analyzed. The problem of government failure is analyzed using models of government behavior. International trade theory and policy are explored in Chapters 17 and 18. International finance is discussed in Chapter 19, and the book concludes with an examination of economies in transition in Chapter 20.

PEDAGOGICAL FEATURES

The following pedagogical features are designed to help the student learn economics.

Case studies within the text. This feature uses real-world situations to help motivate economic ideas and models. Examples include health care in Chapter 1, a

PART 1

Introduction to Economics and Its Foundations

PART 2

Microeconomics over Time and Through Markets

PART 3

The Role of Government

recent drought in the U.S. peanut market in Chapter 3, and setting national park fees in Chapter 4.

Interesting economic puzzles to stimulate interest in economic models. Most chapters begin with a description of real-world phenomena which economics can help to explain. Examples include the opportunity costs of college for Tiger Woods in Chapter 1 and the sharp rise in oil prices during the Persian Gulf War in Chapter 4.

Integrating modern economic concepts in the context of substantive economic problems rather than in separate chapters. This approach demonstrates the relevance of the new ideas and keeps the text to a manageable size. For example, time inconsistency is described in the context of particular economic policy problems.

Use of experimental economics to help explain key ideas in ways that are helpful even to those who do not do such experiments. Details on how to set up and run 18 experiments are provided in an optional experiments manual. The double auction, described in Chapter 7, is one of the experiments featured in this manual and is also the subject of one of the video segments in the Economics Video series.

Brief reviews at the end of each major section (about four per chapter) summarize the key points in abbreviated form as the chapter evolves; these reviews are useful for preliminary skim reading as well as for review.

Boxes to give both current event and historical perspectives. Many of the text's boxes explain how to decipher recent news stories about economic policy. Others examine the contributions of the great economists such as Adam Smith and Alfred Marshall, the history of great ideas, and key historical events.

Functional use of full color to distinguish between curves and to show how the curves shift dynamically over time. An example of the effective use of multiple colors can be found in the discussion of increasing opportunity costs in Chapter 2.

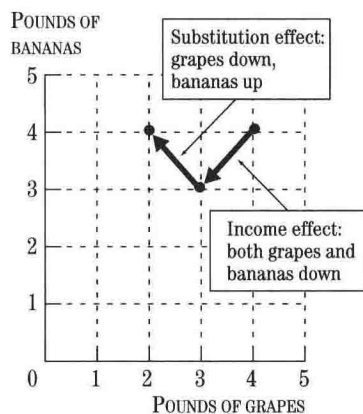
Complete captions and small conversation boxes in graphs. The captions and the small yellow-shaded conversation boxes, such as in the graph in the margin, make many of the figures completely self-contained. In some graphs, sequential numbering of these conversation boxes stresses the dynamic nature of the curves.

Use of photos and cartoons to illustrate abstract ideas. Special care has gone into the selection of photos to illustrate difficult economic ideas such as inelastic supply curves or opportunity costs. Each text photo (many consisting of two or three parts) has a short title and caption to explain its relevance to the text discussion.

Key term definitions in the margin and a listing of the terms at the end of every chapter and appendix. There is also an alphabetized glossary at the end of the book.

Questions for review at the end of every chapter. These are tests of recall and require only short answers; they can be used for oral review or as a quick self-check.

Problems, an essential tool in learning economics, have been carefully selected and tested. An ample supply of these appear in every chapter and appendix. Some of these problems ask the reader to work out examples that are slightly different from the ones in the text; others require a more critical thinking approach. A second set of problems which parallels those at the end of each chapter has been developed for the second edition. Included in the accompanying test bank, this problem set is also available to instructors via the web site.



A COMPLETE PACKAGE OF TEACHING AND LEARNING AIDS

The highly effective teaching and learning package prepared to accompany the text has been completely revised, updated, and expanded. It provides a full range of support for instructors and students.

Study Guide. John Solow of the University of Iowa and Wm. Stewart Mounts, Jr. of Mercer University have prepared the study guide for the text. In my view, this study guide provides a wonderful learning opportunity that many students will value. Each chapter contains an overview, informal chapter reviews, and a section called “Zeroing In,” which harnesses student intuition to explain the chapter’s most important concepts. The study guide also provides ample means for practice in using the economic ideas and graphs introduced in each text chapter. A section called “Working It Out” provides worked problems that take students step by step through the analytical process needed to solve real-world applications of core concepts covered in the chapter. End-of-part quizzes offer students one last chance to test their retention of material before taking in-class exams.

Taylor Tutorial and Simulation Software. A flexible, interactive computerized tutorial is available for students to review basic concepts covered in the text. A tutorial for each chapter in the text provides a second opportunity for students to review concepts and models and then to test themselves on what they’ve learned. A glossary and context-sensitive help are always available. The simulation component of the software includes over 60 years of data on more than 20 key economic indicators, allowing students to graph and compare various measurement instruments and print out their results.

Test Bank. A reliable test bank is the most important resource for efficient and effective learning and teaching. A test bank to go along with the text has been prepared by Stuart Glosser of the University of Wisconsin, Whitewater, and myself. It contains more than 3,000 test questions—including multiple choice, true/false, short answer, and problems—many of which are based on graphs. The questions are coded for correct answer, question type, level of difficulty, and text topic. At the end of each test bank chapter is a set of problems that parallels the end-of-chapter problems from the text.

Computerized Testing Program. A sophisticated and user-friendly program called ESA Test is available so that instructors can quickly create tests according to various selection criteria, including random selection. The program prints graphs as well as the text part of each question. Instructors can scramble the answer choices, edit questions, add their own questions to the pool, and customize their exams in various other ways. The program is available in Windows and Mac versions.

Instructor’s Resource Manual. Prepared by Wm. Stewart Mounts, Jr. of Mercer University, Denise Hixson of Midlands Technical College, and myself, the Instructor’s Resource Manual provides both first-time and experienced instructors with a variety of additional resources for use with the text. Each chapter contains a brief overview, teaching objectives, key terms from the text, a section that orients instructors to the text’s unique approach, and a suggested lecture outline with teaching tips that provide additional examples not found in the text and hints for teaching more

difficult material. Discussion topics and solutions to end-of-chapter text problems are also provided.

Overhead Transparencies. A set of full-color transparencies for all of the numbered figures used to describe the economic models or theories in the text is available for those who are using the text. I usually use two overhead projectors in class so that more than one figure or table can be shown simultaneously.

Power Presentation Manager. This Windows-based software, developed by Houghton Mifflin, allows instructors to create customized lecture presentations that can be displayed on computer-based projection systems. The software, which includes a run-time version of Microsoft PowerPoint, makes available the figures, tables, and key equations from the text and also allows for access to laser disk sequences, instructors' own PowerPoint sets, and screens from other Windows-based software. With the Power Presentation Manager, instructors can quickly and easily integrate all these components—and create their own screens as well—to prepare a seamless classroom presentation with minimal in-class tinkering.

Classroom Experiments: A User's Guide. As I mentioned previously, the text makes use of results from experimental economics to test models and to explain how markets work. I have regularly used experiments in my introductory economics classes—both small sections and large lectures—to illustrate how markets work, and it seems that more and more instructors are incorporating experiments into their classroom teaching. For those instructors who would like to do similar experiments, a lab manual has been prepared by Greg Delemeester of Marietta College and John Neral of Frostburg State University. Written with the first-time user in mind, the manual includes detailed step-by-step instructions for conducting 18 experiments, including the double auction experiment described in Chapter 7 of the text.

Economics Video Series. This exciting teaching tool, which combines footage from my own classroom, animated charts and graphs, and additional narration, brings key economic ideas from the text to life. The video segments can be used as lecture launchers or as a review of material both inside and outside the classroom. The videos also serve as an introduction to some of the concepts that are unique to my text—such as the experimental auction or the development of the model of competitive markets.

Web Site. The web site (<http://www.hmco.com/college>), developed to accompany this text, provides an extended learning environment for students and a rich store of teaching resources for instructors. With materials carefully chosen to complement and supplement each chapter, students will find key economic links for every chapter as well as numerous ways to test their mastery of chapter content—including extended web-based assignments developed by John Kane of SUNY, Oswego. Another feature allows students and instructors to submit questions or comments about the text. Instructors will find a complete set of parallel questions matching the end-of-chapter problems from the text (with answers), economic and teaching resource links, teaching tips, and the opportunity to view and demo the teaching and student software components of the teaching package.

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Completing a project like this is a team effort. I have had the chance to work with an excellent team of professionals at Houghton Mifflin. I worked closely with Bonnie Binkert, Ann West, and Margaret Kearney on this edition and I am grateful to them for their help and encouragement. I would also like to thank Priscilla Abreu, Juli Bliss, Patricia English, Carol Merrigan, Penny Peters, and Adrienne Vincent.

I am grateful to many of my colleagues at Stanford whom I consulted hundreds of times and to the Economics 1 students who used the book and gave me feedback that helped me determine when and where to add that extra sentence of explanation.

Many college teachers and researchers read all or part of the manuscript and gave very helpful comments that were incorporated into revisions. The book would not exist without the help of these reviewers, who are listed below. In particular, I wish to thank David Figlio, Denise Hixson, and David Spencer, who reviewed the text for accuracy during the last stages of production.

My family deserves very special thanks for putting up with me and with the seemingly endless early morning phone calls and piles of manuscript, news clippings, reviews, galleys, and page proof scattered about the house as I worked on the second edition. This book is dedicated to my family.

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Brief Contents

Part 1 Introduction to Economics and Its Foundations 2

1. Observing and Explaining the Economy 4
2. Scarcity, Choice, and Economic Interaction 34
3. The Supply and Demand Model 54
4. Elasticity and Its Uses 88
5. The Demand Curve and the Behavior of Consumers 110
6. The Supply Curve and the Behavior of Firms 144
7. The Interaction of People in Markets 170

Part 2 Microeconomics over Time and Through Markets 198

8. Costs and the Evolution of Firms over Time 200
9. The Rise and Fall of Industries 238
10. Monopoly 262
11. Product Differentiation and Strategic Behavior 290
12. Labor Markets 316
13. Capital Markets 344

Part 3 The Role of Government 370

14. Taxes, Transfers, and Income Distribution 372
15. Public Goods, Externalities, and Government Behavior 404
16. Antitrust Policy and Regulation 436
17. The Gains from International Trade 458
18. International Trade Policy 486
19. International Finance 506
20. Emerging Market Economies 528

Contents

Preface xxiii

Part 1 INTRODUCTION TO ECONOMICS AND ITS FOUNDATIONS 2

Chapter 1 Observing and Explaining the Economy 4

Observations: What Economists Endeavor to Explain 5

Documenting and Quantifying Observations: A Case Study 6

GDP, Health Care, and the Health-Care Share / Overall Price Level, Health-Care Price, and Relative Price

Interpreting the Observations 11

Correlation versus Causation / Controlled Experiments / Experiments in Economics: A New Trend / Faulty Data / The Behavior of People Underlying the Observations

Economic Models 15

What Are Economic Models? 15

An Example: A Model with Two Variables / Prediction and the Ceteris Paribus Assumption

Microeconomic Models versus Macroeconomic Models 17

The Use of Existing Models 19

The Development of New Models 19

Using Economics for Public Economic Policy 20

Positive versus Normative Economics 20

Economics as a Science versus a Partisan Policy Tool 21

Economics Is Not the Only Factor in Policy Issues 21

Conclusion: A Reader's Guide 21

Key Points 23 • Key Terms 23 • Questions for Review 23 • Problems 24

► *Using Economics to Explain Gender Pay Gaps 18*

Appendix to Chapter 1 Acquiring an Eye for Economics: Reading and Understanding Graphs 25

Representing Observations with Graphs 25

Time-Series Graphs 25

Time-Series Graphs Showing Two or More Variables 28

Scatter Plots 29

Pie Charts 29

Representing Models with Graphs 30

Slopes of Curves 30

Graphs of Models with More than Two Variables 31

Key Terms and Definitions 32 • Questions for Review 32 • Problems 32

Chapter 2 Scarcity, Choice, and Economic Interaction 34

Scarcity, Choice, and Interaction for Individuals 35

Consumer Decisions 35

Scarcity and Choice for Individual Consumers / Gains from Trade / Improvements Through Reallocation

Producer Decisions 37

Scarcity and Choice for Individual Producers / Gains from Trade / Specialization, Division of Labor, and Comparative Advantage

Trade Within a Country versus International Trade 38

Multilateral Trade and the Need for a Medium of Exchange 40

Different Money in Different Countries / Exchange Rates

Scarcity and Choice for the Economy as a Whole 41

Production Possibilities 41

Increasing Opportunity Costs 42

The Production Possibilities Curve 42

Inefficient, Efficient, or Impossible? / Economic Growth: Shifts in the Production Possibilities Curve / Scarcity, Choice, and Economic Growth

Market Economies, Command Economies, and Prices 47

Three Questions 47

Key Elements of a Market Economy 48

Freely Determined Prices / Property Rights and Incentives / Competitive Markets / Freedom to Trade at Home and Abroad / A Role for Government / The Role of Nongovernment Organizations

Prices in Action: An Example 50

Conclusion 51

Key Points 51 • Key Terms 52 • Questions for Review 52 • Problems 52

► *Adam Smith, 1723–1790 39*

► *Using Economics to Explain Educational Choice and Economic Growth 45*

Chapter 3 The Supply and Demand Model 54

Demand 55

The Demand Curve 55

Shifts in Demand 56

Consumers' Preferences / Consumers' Information / Consumers' Incomes / Number of Consumers in the Population / Consumers' Expectations of the Future / Prices of Closely Related Goods

Movements Along versus Shifts of the Demand Curve 59

Supply 60

The Supply Curve 61

Shifts in Supply 62

Technology / The Price of Goods Used in Production / The Number of Firms in the Market / Expectations of Future Price / Government Taxes, Subsidies, and Regulations

Movements Along versus Shifts of the Supply Curve 65

Market Equilibrium: Combining Supply and Demand 65

Determination of the Market Price 66

Finding the Market Price / Two Predictions

Finding the Equilibrium with a Supply and Demand Diagram 68

A Change in the Market 69

Effects of a Change in Demand / Effects of a Change in Supply / When Both Curves Shift

Using the Supply and Demand Model: A Case Study 73

Explaining and Predicting Peanut Prices 73

*Drought in the Southeast / A Change in the Foreign Peanut Quota?***Interference with Market Prices 79**

Price Ceilings and Price Floors 79

Shortages and Related Problems Resulting from Price Ceilings 79

Dealing with Persistent Shortages / Making Things Worse

Surpluses and Related Problems Resulting from Price Floors 81

Conclusion 84

Key Points 84 • Key Terms 85 • Questions for Review 85 • Problems 85

► *Overview of Supply and Demand* 66► *Reading the News About Supply and Demand* 78► *Reading the News About Price Floors* 83

Chapter 4 Elasticity and Its Uses 88**The Price Elasticity of Demand 89**

The Importance of Knowing the Price Elasticity of Demand 89

High versus Low Elasticity / The Impact of a Change in Supply on the Price of Oil

Definition of the Price Elasticity of Demand 92

*The Minus Sign Is Implicit / The Advantage of a Unit-Free Measure /**Elasticity versus Slope*

Terminology for Discussing Elasticities 93

Elastic versus Inelastic Demand / Relatively Elastic versus Relatively Inelastic Demand / Perfectly Elastic versus Perfectly Inelastic Demand

Elasticities and Sketches of Demand Curves 95

Calculating the Elasticity with a Midpoint Formula 95

Revenue and the Price Elasticity of Demand 96

The Two Effects of Price on Revenue

Differences in the Price Elasticity of Demand 98

The Degree of Substitutability / Big-Ticket versus Little-Ticket Items / Temporary versus Permanent Price Changes / Long-Run versus Short-Run Elasticity

Elasticities Related to Shifts in Demand 100

The Price Elasticity of Supply 101

Why the Price Elasticity of Supply Is Important 101

Definition of the Price Elasticity of Supply 102

Applications of Elasticity 105

The Size of the Oil Price Increase 105

Setting National Park Fees 105

Taxes and Labor Supply 107

Conclusion 107

Key Points 107 • Key Terms 108 • Questions for Review 108 • Problems 108

► *Alfred Marshall, 1842–1924* 106

Chapter 5 The Demand Curve and the Behavior of Consumers 110**Utility and Consumer Preferences 111**

A Consumer's Utility Depends on the Consumption of Goods 111

Marginal Utility 112

Utility from More than One Good	114
<i>Utility Indicates Preference / More General Representations of Utility</i>	
The Budget Constraint and Utility Maximization	117
The Budget Constraint	117
Maximizing Utility Subject to the Budget Constraint	119
<i>Effect of a Change in Price: A Movement Along a Demand Curve / Effect of a Change in Income: A Shift in the Demand Curve / Income and Substitution Effects of a Price Change / Rules for Utility Maximization</i>	
The Diamond–Water Paradox	123
Willingness to Pay and the Demand Curve	125
Measuring Willingness to Pay and Marginal Benefit	125
Graphical Derivation of the Demand Curve	126
The Price Equals Marginal Benefit Rule	129
The Market Demand Curve	129
Different Types of Individuals	129
Different Prices for the Same Good	130
Consumer Surplus	131
An Application: Saving	133
Price of Future Consumption versus Present Consumption	134
The Real Interest Rate	134
Saving and the Interest Rate	134
Conclusion	135
Key Points 135 • Key Terms 136 • Questions for Review 136 • Problems 136	
▶ <i>Using Economics to Explain Family Decisions</i>	124
▶ <i>The Origin of Consumer Surplus</i>	132
Appendix to Chapter 5 Budget Lines and Indifference Curves	138
Part A: The Budget Line	138
Part B: The Indifference Curve	139
Getting to the Highest Indifference Curve Given the Budget Line	141
Effect of a Price Change on the Quantity of X Demanded	141
Effect of an Income Change on Demand	142
Conclusion	142
Key Points 142 • Key Terms and Definitions 143 • Questions for Review 143 • Problems 143	
<hr/>	
Chapter 6 The Supply Curve and the Behavior of Firms	144
The Individual Firm	145
The Nature of Firms	145
<i>Different Legal Forms of Firms / How Many Firms Are There?</i>	
An Example: Your Own Firm	147
<i>The Firm as a Price-Taker in a Competitive Market / Other Types of Markets</i>	
The Firm's Profits	149
Total Revenue	150
Production and Costs	150
<i>The Time Period / The Production Function / Costs / Graphical Representation of Total Costs and Marginal Cost</i>	