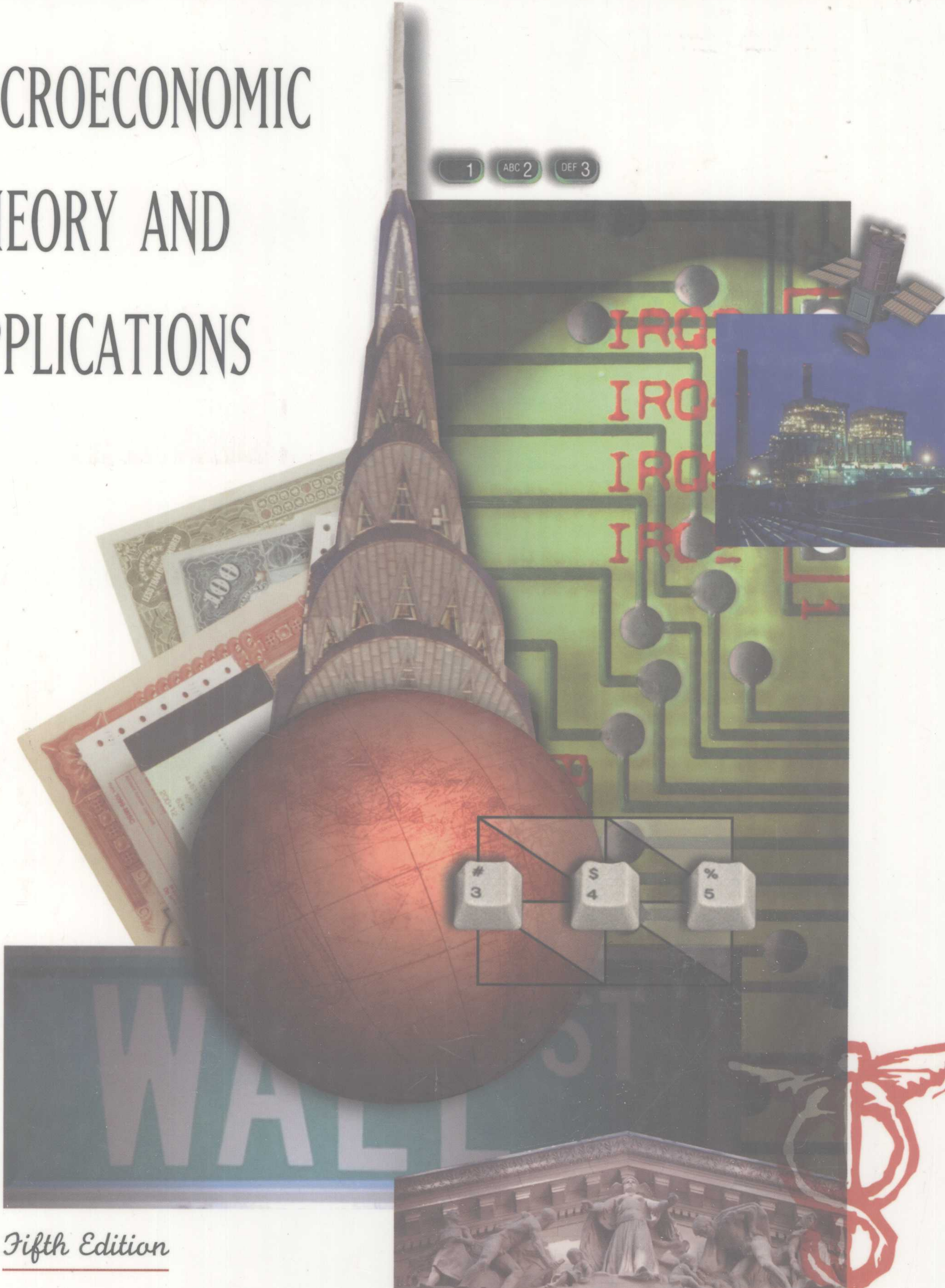
MICROECONOMIC THEORY AND APPLICATIONS



Fifth Edition

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Microeconomic Theory and Applications

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HarperCollinsCollegePublishers

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Electronic Page Makeup: Interactive Composition Corporation
Printer and Binder: R. R. Donnelley & Sons Company
Cover Printer: New England Book Components

MICROECONOMIC THEORY AND APPLICATIONS, *FIFTH EDITION*

Library of Congress Cataloging-in-Publication Data

Browning, Edgar K.
Microeconomic theory and applications / Edgar K. Browning,
Mark A. Zupan.— 5th ed.
p. cm.
Includes index
ISBN 0-673-523810
1. Microeconomics. 2. Microeconomics—Examinations, questions, etc. I. Browning, Edgar K. II. Zupan, Mark A. III. Title.
HB172.B864 1995
338.5—dc20
95-17546
CIP

95 96 97 98 9 8 7 6 5 4 3 2 1

Preface

The study of how markets operate is the cornerstone of microeconomic theory, and understanding how markets operate is essential to understanding how our economic system functions. Beyond developing a coherent view of economic reality, microeconomics provides techniques that increasingly play roles in both public policy formulation and private decision making. Although macroeconomic issues frequently receive more visible media attention, the ways in which innumerable microeconomic issues are resolved have a far greater and more enduring impact in shaping our economic environment.

We believe that microeconomics is the most important course in the undergraduate economics curriculum. We also believe that understanding microeconomics provides an essential foundation to any bachelor's or master's degree business student. Our intention in writing *Microeconomic Theory and Applications* was to develop a text for economics and business students that will teach them the theory and how to use it correctly. To this end, we have presented basic microeconomic principles in a clear, thorough way, using numerous applications to illustrate the use of theory and to reinforce students' understanding of it. This approach gives students the fundamental tools of analysis and teaches them how to think about problems using the analytical framework that economists have found so useful.

Organization and Content

The fifth edition of *Microeconomic Theory and Applications* continues to reflect the belief that it is better for students to be exposed to thorough coverage of fundamental microeconomic concepts and techniques than to superficial treatment of a great number of topics, many of which will never be encountered again. The enthusiastic reception given the first four editions suggests that a large number of instructors also share this view. Apart from this emphasis on the core principles of microeconomics and how to use them, the text is by and large conventional in structure and organization except for one feature: There are five chapters devoted exclusively to applications. These are Chapter 3, "Using the Supply-Demand Model"; Chapter 6, "Using Consumer Choice Theory"; Chapter 11, "Using the Competitive Model"; Chapter 16, "Using Noncompetitive Market Models"; and Chapter 19, "Using Input Market Analysis."

A further feature of the text that deserves mention is the attention given to input market analysis. Traditionally, this has been a weak area in most microeconomics texts, seldom with more than two, and frequently only one, chapter(s) on the subject. Yet in a fundamental quantitative sense, input markets and product markets are of equal importance because the sum of incomes generated in input markets (national income) equals total outlays on goods and services (national product). Moreover, public policy issues relating to input markets have become increasingly important, as suggested by recent attention given to managerial compensation, income distribution, welfare programs, discrimination, comparable worth, interest rates and investment, and minimum wage legislation. Consequently, we devote three chapters to the subject of input market analysis (Chapters 17 through 19).

Because all microeconomics courses are not taught the same way, the text is designed to give instructors great flexibility in adapting the book to their requirements. For example, in a short course emphasizing the theoretical underpinnings of partial equilibrium analysis, the instructor might cover only Chapters 1 through 5, 8 through 12, 17, and 18. A longer, more theoretically oriented course could include all chapters except the applications chapters. Generally, however, we expect that most instructors will steer a middle course and select three or four applications from each of these chapters (the way we normally use the material). In addition, instructors can either assign the applications as they appear in the text—following the development of the theory—or integrate them into their presentations of the theory chapters.

Applications

As the space devoted to them suggests, we believe that a large dose of applications is an essential ingredient in any microeconomics course. Although economists know that microeconomics is important and often exciting, students need to be convinced that this is so. Applications serve this purpose. In addition, they enliven the subject for students and help them better appreciate the theory. Time permitting, the more applications covered, the better prepared students will be to use the theory on their own.

Each of the five applications chapters (Chapters 3, 6, 11, 16, and 19) contains four to six longer applications that use and reinforce the graphical and logical techniques developed in the theory chapters. In Chapter 3, for example, the basic supply and demand framework developed in Chapters 1 and 2 is used to examine, among other topics, international trade, an import quota on sugar, rent control, the incidence of gasoline taxes, and the pricing of cable television service. Chapter 11, "Using the Competitive Model," includes analyses of local taxi cab markets, the market for Los Angeles smog, and airline deregulation. In Chapter 19, "Using Input Market Analysis," the theory is applied to discrimination, the incidence of the Social Security payroll tax, the government budget deficit, and the effects of the National Collegiate Athletic Association on college football players.

Applications are not relegated exclusively to the five applications chapters; all other chapters contain several shorter applications. We feel, however, that it is appropriate to use more applications in some areas than in others. For example, it seems a misallocation of limited textbook space to include as many applications for general equilibrium theory as for the competitive and monopoly models. Not only are the applications in the latter two areas likely to be more interesting to students, they are also likely to provide more useful background for students' later work.

Changes in the Fifth Edition

There are more changes in this edition than in any edition since the book was first written. The changes, made in response to reviewer and user comments as well as to new developments in the field, occur in four principal areas.

More Than 100 New Applications

More than 100 applications, some short, others of greater length, have been added to the text. For example, Chapter 6, "Using Consumer Choice Theory," now includes an explanation of why company health benefits are tax exempt; an overview of the economics and politics of school vouchers; the pricing of trash collection and its effect on recycling; an analysis of the difference between law and doctoral student parking lots; an investor-choice model and how it can be employed to explain the risk-return preferences of professors; and a description of the deadweight loss associated with Christmas gift-giving. Chapter 7, "The Cost of Production," includes a description of cost minimization at American Airlines; a comment on public versus private provision of schooling and postal services; an explanation for changes over time in the minimum efficient scale of producing beer, lawsuits, and soft drinks; an analysis of input substitution in the raising and razing of buildings; an examination of why the Yale hockey team typically features players who are slower but brawnier than does the Harvard hockey team; and an overview of economies of scope and the role this concept plays in explaining oil company diversification and full-service banking. The other chapters feature similar additions. The applications have been added to enhance what we believe has always been the hallmark of the text and what we want to remain its most important competitive advantage: the emphasis on illuminating microeconomic theory through telling, real-world examples.

Greater Relevance for Business Students

In revising the text, we also have sought to make the material more useful to business students. Nationwide, business schools account for roughly 25 percent of all the undergraduate and master's degrees granted by universities. Since business school curricula typically include a healthy dose of microeconomics, making our text relevant for the students in these programs has been a key objective. The added material includes sections on the estimation of demand and cost (Chapters 5 and 9, respectively); the economics of risk, uncertainty, and investor choice (Chapter 6); pricing strategies in monopoly markets (Chapter 13); and numerous new examples from the business world. These changes have been made without compromising the value of the text for a liberal arts economics major or a more theoretically oriented professor.

More on the Basics of Supply and Demand

The third significant change in this edition is that more of the text has been devoted to the basics of supply and demand, notably Chapters 1 through 3. Material on opportunity cost, elasticities, consumer and producer surplus, and international trade has been shifted to the front of the text and expanded in response to feedback from instructors that they typically spend more time reviewing this foundation-building material at the beginning of their courses. We have taken their input to heart in the revision and have created space for the expanded coverage by trimming some of the material in the last few chapters of the book.

Enhanced Coverage of International and Public Policy Considerations

Finally, given the increasing internationalization of today's business world and the ever-growing role played by government in our society, we have devoted more attention to the consequences as well as the causes of these two important topics. For example, Chapter 11 includes an analysis of foreign exchange markets and the European currency crisis of 1992. An application in Chapter 7 investigates the manner in which government policymakers regulate water markets in California.

Pedagogical Aids

In addition to the use of applications, several other in-text pedagogical aids should be mentioned.

Graphs

We have paid careful attention to the graphs used in the text. Unusually thorough explanations of graphs are given. Furthermore, the explanatory captions and the liberal use of color will help students follow the text discussion and understand graphical analysis.

End-of-Chapter Aids

At the end of each theory chapter is a Summary that highlights the important points of the chapter and a list of Key Concepts and Terms to help students test their knowledge of the basic material. Nearly 400 Review Questions and Problems help students review chapter material and require them to solve analytical exercises. Answers to some of these questions and problems are provided at the end of the book.

Ancillaries

A *Study Guide* prepared by John Lunn, Hope College, is available to give students further review and practice in the use of microeconomic theory. An *Instructor's Manual,* written by the text authors, accompanies the text. Each chapter in the manual features a chapter outline, general comments on the chapter, specific section-by-section comments, and suggestions that may help in developing lectures and class discussion topics. The *Test Bank,* by Clark G. Ross and Vikram Kumar, both of Davidson College, contains 1,400 multiple-choice questions with answers, along with review questions and problems. This test bank is available on Testmaster, a computerized testing system available to adopters, which allows users to create and customize tests and solution keys.

Six software modules are available for the IBM PC, covering elasticity, consumer choice, competition, monopoly, input markets, and game theory. Written by Richard Alston and Wan Fu Chi of Weber State College, the modules encourage students to explore the graphical and analytical relationships described in the text. Numerous problem-solving exercises using the software modules are provided in an accompanying booklet prepared by Sarah L. Glavin of Boston College.

Acknowledgements

We have been fortunate to have had the assistance of many able economists in the preparation of this book. Those who have worked at various stages in the development of the first four editions include:

Jeff Baldani, Colgate University
David Black, University of Delaware
David Blau, University of North Carolina
Larry Blume, University of Michigan
Wayne Boyet, University of Mississippi
Charles Breeden, Marquette University
Charles A. Capone, Baylor University
Richard Caves, Harvard University

Alvin Cohen, Lehigh University
Patrice Karr Cohen, University of Mississippi
Darius Conger, Central Michigan University
David Conn, University of Kansas
Robert Connolly, University of North Carolina at Greensboro
Keith J. Crocker, Pennsylvania State University
Carl Davidson, Michigan State University
Robert Ekelund, Auburn University
David Emmons, Wayne State University
Ian Gale, University of Wisconsin
David Gay, University of Arkansas
John Goddeeris, Michigan State University
Warren Gramm, Washington State University
James M. Griffin, Texas A&M University
Timothy Gronberg, Texas A&M University
Glenn Heuckel, Purdue University
Barry Hirsch, University of North Carolina at Greensboro
W. L. Holmes, Temple University
Art Kartman, San Diego State University
Edward Kittrell, Northern Illinois University
Leonard Lardaro, University of Rhode Island
Daniel Y. Lee, Shippensburg University
Al Link, Auburn University
William McEachern, University of Connecticut
Mark Machina, University of California, San Diego
D. E. Mills, University of Virginia
William Novshek, Stanford University
Richard E. Olsen, Washburn Universit
William O'Neil, Colby College
H. Craig Petersen, Utah State University
Jeffrey Pliskin, Hamilton College
John Riley, University of California, Los Angeles
Hubert O. Sprayberry, Howard Payne University
Stanley Stephenson, Pennsylvania State University
Bryan Taylor, California State University
Roger Trenary, Kansas State University
Roy Van Til, Bentley College
Don Waldman, Colgate University

In addition, the following economists assisted with the development of the fifth edition manuscript:

Peter Aranson, Emory University
Charles Breeden, Marquette University
Keith Crocker, Pennsylvania State University
Cliff Dobitz, North Dakota State University
Maxim Engers, University of Virginia
Charles Geiss, University of Missouri
Soumen Ghosh, New Mexico State University
Robert Goldfarb, George Washington University
Joseph Jadlow, Oklahoma State University
Tom Lee, California State University, Northridge
Christine Loucks, Boise State University
Robert Main, Butler University
Robert Maness, Louisiana State University
Roger Morefield, University of Saint Thomas
Patrick B. O'Neill, University of North Dakota
Lydia Ortega, San Jose State University
Michael Reclam, Virginia Military Institute
David Sisk, San Francisco State University
William Doyle Smith, University of Texas at El Paso
Douglas Stewart, San Diego State University
Shirley Svorny, California State University, Northridge
Wayne Talley, Old Dominion University
Donald Wells, University of Arizona.

These reviewers were generous with their time and their comments have greatly enhanced the quality of the book. To them we extend our gratitude and hope the final product meets with their approval.

Special mention should be made of the late Jacquelene M. Browning, who was the co-author of the first four editions. Her pedagogical skills, together with her insistence that the text be one from which students could learn effectively, continue to have a profound influence in the present edition.

Cary Atlas, Partha Chaterjee, Hemant Chawla, Kate Dennington, Grace Gee, Tom Molyneux, Roland Wilcox and Lee Young have provided outstanding research and editorial assistence. Edie Trimble was thoroughly diligent and accommodating in proofreading the manuscript. Carol Shuherk, a professor of Business Communication at USC, read the entire manuscript for clarity and offered numerous suggestions that significantly improved the readability of this edition. We would also like to thank the people at HarperCollins who made important contributions to this edition, in particular, Executive Editor John Greenman, Developmental Editor Becky Kohn, and Project Editors Diane Williams and Olive Collen.

This book is dedicated to our families without whose unflagging encouragement and support our vision for the book would have never become a reality.

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