

Timothy Tregarthen
economics
Libby Rittenberg

Second
Edition

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economics

Second Edition

Timothy Tregarthen
University of Colorado
Colorado Springs

Libby Rittenberg
The Colorado College
Colorado Springs

Worth Publishers

To our children

Economics, Second Edition

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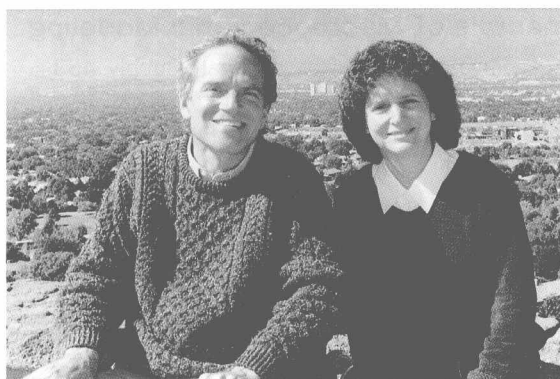
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Preface

The preface to the first edition of *Economics* noted not very long ago that recent developments—new trade agreements, the transition of many countries to market-based economic systems, and improvements in communications technology—were transforming the world at breathtaking speed. The pace of change has certainly not slowed down. The explosive development of the internet, the transformation of perennial U.S. federal budget deficits into surpluses, the difficulties encountered by some countries of the former Soviet bloc in converting to market-based economic systems, and a series of financial crises in Asia are but a few of the events that have had a direct impact on our lives since 1996, when *Economics* was first published. Even the speed with which books are produced has accelerated, to the point of allowing us to incorporate the 1996 base-year and comprehensive revision of NIPA data released by the Department of Commerce, Bureau of Economic Analysis, just six weeks before the text's publication. The economic way of thinking provides a set of powerful tools that we can use to understand the world—regardless of how much and how fast it changes.

The goal of this edition of *Economics* is to teach the basic principles of economics and to emphasize their relevance in today's world. We use applications from sports, politics, campus life, and other familiar settings to illustrate the links between theoretical principles and common experiences. Because of the increasingly global nature of economic activity, we also recognize the need for a clear and consistent international focus throughout an economics text. Therefore, we have broadened the scope of the book to include even more examples and applications from all over the world. Finally, we have tried to provide a sense of the intellectual excitement of the field and an appreciation for the gains it has made, as well as an awareness of the challenges that lie ahead.

Unifying Themes

To be sure that students realize that economics is a unified discipline and not a bewildering array of seemingly unrelated topics, we develop the presentation of microeconomics and macroeconomics around integrating themes.

The integrating theme for microeconomics is the marginal decision rule, a simple approach to choices that maximize the value of some objective. The marginal decision rule is presented in an intuitive manner in Chapter 6 and applied as an integrating device throughout the discussion of microeconomics. Instead of a hodgepodge of rules for different market conditions, we give a single rule that can be applied within any market setting. Chapter 6 also investigates conditions under which maximizing choices will—and will not—lead to desirable outcomes. This chapter provides a clear perspective on the strengths and limitations of markets, as well as on the role of government in the economy.

The integrating theme for macroeconomics is the model of aggregate demand and aggregate supply, introduced in broad outline in Chapter 22. We explain how the model of demand and supply that is presented in Chapter 3 is adapted and applied in the study of macroeconomics. Chapter 22 explains both long-run and short-run equilibria and introduces the concepts of the multiplier, inflationary and recessionary gaps, and stabilization policy. By the end

of the chapter, we have developed a framework for addressing the key issues of macroeconomics. Subsequent chapters use the model of aggregate demand and supply to show how the macroeconomy works.

Organization

While we have ordered the chapters in a way that we believe makes sense, we recognize that others may want to present topics in a different sequence and to pick and choose among various topics. We have carefully written the chapters so that, after covering the core introductory chapters (Chapters 1–4) and a few basic chapters in microeconomics or macroeconomics, an instructor can assign chapters out of numerical order. If desired, macroeconomics, which begins with Chapter 20, can be covered first. Economic principles that are common to both microeconomics and macroeconomics are covered in both sections of the text.

Within the microeconomics section, the sequence can be varied once the basic tools have been introduced in Part 2 (Chapters 5 through 8), so that it is possible, say, to cover competitive product and factor markets (Chapters 9, 12, and 13) before discussing imperfectly competitive product and factor markets (Chapters 10, 11, and 14). Within the macroeconomics section, the chapters can be re-ordered once the basic concepts of macroeconomics, presented in Part 7 (Chapters 20 and 21), and the fundamentals of macroeconomic modeling, presented in Part 8 (Chapters 22–25), have been developed. This sequence would allow instructors to cover the private-sector components of aggregate demand (Chapters 28–30) prior to discussing stabilization policies (Chapters 26 and 27) if they desire to do so. It is also possible, of course, to pick and choose among these chapters. Thus the text allows a great deal of flexibility.

The Core Chapters

First impressions are critical, so we've devoted great energy to making the core chapters of the text (Chapters 1–4) as clear and as engaging as possible.

Continuing the tradition of the first edition, we begin Chapter 1 with *A Day in the Life of a Nation*. As we were getting the manuscript ready to go to press, we picked a single day in February 1999 and selected events reported in newspapers from all over the country. Those events provide lively and relevant examples of how economics applies to everyone. Students will see how stories ranging from Nike Corporation's treatment of workers at its factories in southeast Asia to a \$3.3 billion charitable donation by Bill and Melinda Gates relate to economics and to the material they will be studying in the course. Economics is the study of choice, and we use these examples to focus on the choices that individuals make and on the opportunity costs of those choices. This chapter also looks at careers in economics, the benefits of an undergraduate major in economics, and the usefulness of even a little study of economics.

The appendix to Chapter 1 provides a comprehensive explanation of essentially all the graphical and mathematical tools used throughout the text. Some students are quite comfortable with these tools, but many are not. This thorough appendix will be extremely helpful to those students who are anxious about the course. It will enable them to overcome their trepidation about the way economics is presented so that they can focus better on the content and significance of the new ideas and ways of thinking they will encounter throughout the text.

Chapter 2 explains the production possibilities model and Chapter 3 presents the model of demand and supply. To make these central chapters clear *and* exciting, we have incorporated many real examples that will engage students. To introduce the topic of production possibilities, we talk about Fort Ord, a former military base that was recently converted to a university campus, California State University, Monterey Bay. We explain the production pos-

sibilities model with a sustained example using snowboards and skis. To open the discussion of demand and supply in Chapter 3, we talk about the way in which Starbucks changed the coffee-drinking habits of Americans, and then continue using coffee as an example throughout the chapter to flesh out the model of demand and supply.

To complete the core, we include a new chapter on applications of demand and supply (Chapter 4). Our goal in this chapter is to show the wide range of applications of the demand and supply model. We chose the market for personal computers, the stock market, and the market for health care services to demonstrate the relevance of the model and the breadth of its application. Price floors and price ceilings also provide excellent examples of the power of the model of demand and supply.

Microeconomics

After explaining how maximizing behavior in general leads to the marginal decision rule in Chapter 6, we complete our coverage of the basic tools of microeconomics with a chapter on consumer behavior (Chapter 7) and one on production and cost (Chapter 8). Chapter 7 ends with an optional section on indifference curve analysis. An appendix to Chapter 8 on the use of isocost curves and isoquants to understand how firms choose efficient levels of factors of production is available at the book's web site: <http://www.worthpublishers.com/tregarthen>. Copies of this appendix can also be ordered from the publisher.

Part 3 (Chapters 9 through 11) examines product market structures and Part 4 (Chapters 12 through 14) covers markets for factors of production. Although the relationship of government to the private sector is discussed in many places throughout microeconomics, Part 5 is devoted specifically to this topic. These chapters discuss public finance and public choice (Chapter 15) and antitrust policy and business regulation (Chapter 16). The three chapters in Part 6 apply microeconomic analysis to international trade (Chapter 17), environmental issues (Chapter 18), and inequality, poverty, and discrimination (Chapter 19).

Macroeconomics

Chapters 20–25 provide a complete introduction to the core topics of macroeconomics. Chapter 20 engages students with a discussion of the key macroeconomic issues: growth of total output and the business cycle, changes in the price level, and unemployment. Chapter 21 introduces GDP accounting and examines how consumption, investment, government purchases, and net exports affect economic activity.

Chapter 22 presents the model of aggregate demand and aggregate supply, our integrating theme for macroeconomics. The chapter on economic growth (Chapter 23) builds on the aggregate demand–aggregate supply model, with a special focus on the long run. Two chapters on money and financial markets (Chapters 24 and 25) complete Part 8.

Part 9 (Chapters 26 and 27) provides a closer look at monetary and fiscal policies, while Part 10 (Chapters 28 through 30) focuses on the private sector components of aggregate demand. In Chapter 28 we present the aggregate expenditures model.

Part 11 presents macroeconomics from a historical perspective. Chapter 31 uses the aggregate demand–aggregate supply model to explain the phases of inflation and unemployment that the United States has experienced over the past forty years. Chapter 32 shows how the actual performance of the U.S. economy since the 1930s has influenced macroeconomic theory and changed the way monetary and fiscal policy are used. It highlights the major debates concerning the way macroeconomies work and points out where economists agree and disagree. The text ends with a discussion of challenges for the future in Part 12, with chapters on economic development (Chapter 33) and economies in transition (Chapter 34).

Features and Learning Aids

Recognizing that a course in economics may seem daunting to some students, we've tried hard to make *Economics* a clear and engaging text. Clarity comes in part from the intuitive presentation style, but we've also integrated a number of pedagogical features that we believe make learning economic concepts and principles easier and more fun. These features, like the rest of the text, are very student-focused.

Getting Started chapter introductions set the stage for each chapter with an example that we hope will motivate readers to study the material that follows. These essays on topics such as the value of a college degree in the labor market and what life would be like in the United States if the country had experienced no economic growth over the last fifty years present issues or events that lend themselves to the type of analysis explained in the chapter. We refer to these examples later in the text as evidence of the link between theory and reality.

Case in Point essays within the chapter illustrate the influence of economic forces on real issues and real people. When students read about the Oprah Winfrey book club and about the lawsuit brought against Ms. Winfrey by a group of cattlemen, they see her not just as a television star, but also as a possible demand shifter. In another chapter, a distributor of kitchen appliances to building contractors talks about what it means to be a price taker in a competitive market. In yet another chapter, we explore the impact of the euro on the countries that have adopted the new currency and on other countries.

Highlighting of key terms and definitions within the text enables students to review them in context, a process that enhances learning. A list of key terms with page references to the definition appears at the end of each chapter, and all highlighted terms are included in the Dictionary of Economic Terms at the back of the book.

Checklists at the conclusion of major sections of each chapter review the key points covered in that section. At the end of each chapter, **A Look Back . . . A Look Ahead** summarizes the material covered in the chapter and briefly previews subsequent chapters.

Try It Yourself problems following most major sections of the text give students the opportunity to be active learners. These problems, which are answered completely at the end of each chapter, give students a clear signal as to whether they understand the material before they go on to the next topic.

Caution! notes throughout the text warn of common errors and explain how to avoid making them. After our combined teaching experience of more than fifty years, we have seen the same mistakes made by many students. Confusing the difference between a shift in demand and movement along the demand curve is a typical one. Caution! notes, which are easily spotted in the margins of the text, provide additional clarification and show students how to avoid common mistakes.

For Discussion questions at the end of each chapter are intended to promote discussion of the issues raised in the chapter and to engage students in critical thinking about the material. This section includes not only general review questions to test basic understanding but also examples drawn from the news and from results of economics research.

Problems, which follow the discussion questions, provide numerical exercises as a further test of understanding.

Supplements for Students

Study Guide

Prepared by John Brock and Dale DeBoer of the University of Colorado, Colorado Springs, the *Study Guide* reinforces the material covered in the text. For each chapter, the *Study Guide* provides chapter objectives, walks students step-by-step through the chapter, and quizzes

students with pre-tests and post-tests. Many of the *Study Guide* chapters also contain a section called “Are You Confused?” to help students having difficulty with core concepts. More advanced students who want to delve a little further into the chapter’s topics will find a section called “Enrichment.”

Economics 2e Companion Web Site

Found at <<http://www.worthpublishers.com/tregarthen>>, the web site to accompany *Economics 2e* offers valuable tools, including online simulations, designed to help students master economic concepts. These tools include interactive exercises, graphing modules, and student quizzes. In addition, the site features *The Margin Online*, which contains timely articles on everyday economic issues, as well as frequent updates, including new web links, exercises, and developments in economics.

Student Activities CD-ROM

This CD-ROM contains multimedia content from the *Economics 2e* companion web site, including basic drill and practice exercises, interactive simulations, graphing modules, and student quizzes. This CD-ROM is ideal for students with limited web access or for use in a lab setting.

Supplements for Instructors

Instructor’s Resources Manual

The *Instructor’s Resources* manual by Virginia Lee Owen of Illinois State University includes chapter overviews and outlines, learning objectives, common student difficulties, suggestions for active learning, such as annotated web sites, and lecture supplements. The manual also includes complete instructions for 12 in-class experiments, provided by John Brock, that provide hands-on learning experiences for students. A section called “Theory in Focus” presents Cases in Point not included in the text. Instructors will also find in this manual a list of readings, audio/video aids, and software to aid in class preparation and presentation.

Solutions Manual

The *Solutions Manual* contains answers for all discussion questions and problems found at the end of each text chapter.

Test Bank

Written by Paul Ballantyne of the University of Colorado, Colorado Springs, the print *Test Bank* for *Economics 2e* offers over 2,000 multiple choice, true/false, and short essay questions that test comprehension, interpretation, analysis, and synthesis.

Computerized Test Bank

The *Test Bank* is also available in CD-ROM format for both Windows and Mac users. Instructors can download the test bank and then edit, add, and resequence questions to suit their needs.

Online Testing

The *Test Bank* CD-ROM allows instructors to create and administer exams on paper, over a network, and over the internet as well. Multimedia, graphics, movies, sound, and interactive

activities can be included in the questions. Security features allow instructors to restrict tests to specific computers or time blocks. The CD also includes a suite of grade book and question analysis features.

Q & A Online

The *Economics* 2e companion web site allows instructors to conduct and evaluate quizzes on the web at <<http://www.worthpublishers.com/tregarthen>>.

PowerPoint Slides

This PowerPoint set includes each figure from *Economics* 2e, enhanced with a text outline. Available from the companion web site, the slides can be used directly or customized.

WebCT

On request from instructors, the text's media content is available in WebCT format for use in creating course web sites and/or online courses. WebCT includes content, threaded discussions, quizzing, a grade book, a course calendar, and a number of other specialized features.

The Margin Online

Beginning with *The Best of The Margin*, a selection of classic articles, games, and puzzles from *The Margin*, the popular periodical founded and edited by Timothy and Suzanne Tregarthen, has been relaunched. New articles will be posted to the *Economics* 2e companion web site <<http://www.worthpublishers.com/tregarthen>>.

Transparencies

Instructors can obtain more than 200 vivid color acetates of text figures, enlarged for superior projection quality.

Videos

Economics is the text chosen to accompany the economics telecourse developed by the Dallas County Community College District. For use in class, instructors have access to videos produced by the DCCCD, the nation's leading developer of distance learning materials. These videos dramatize key economics concepts.

Acknowledgments

A text is truly the joint product of the efforts of hundreds of people. We have been humbled and gratified by the enormous contributions of colleagues around the country and the staff at Worth Publishers that have made this book possible. With pleasure, we acknowledge our debt to them.

We are most grateful to Richard Alston of Weber State University. He's been with us from beginning to end, and we could not have completed this book without him. He has been our consultant, advisor, partner, co-conspirator, collaborator, prodder, and friend. His contributions and ideas have enriched this book greatly. In addition, he has played a major role in the development of the *Study Guide*, the *Test Bank*, and the *Instructor's Resources* manual to ensure their coordination with the text. We cannot thank him enough (and we mean it, Dick!).

Our colleagues who reviewed various drafts of *Economics*, 1e and 2e, have made tremendous contributions to its development. We gratefully acknowledge them here. Early in the development of the second edition we held a two-day conference to discuss a variety of issues. We were joined there by the authors of the supplements and a group of peer reviewers. They told us what they thought and we took their comments to heart. We learned much from their insights. We note those who participated in the focus group with an asterisk (*) in the list below.

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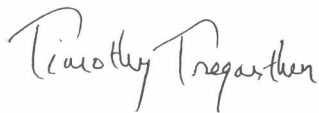
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We also thank those who tried to make us better writers. Judith Kromm, the Worth development editor, stayed with us from beginning to end. ("Can't you clarify this?" "Make that more exciting?" "Add one more Case in Point?") We benefited greatly from her care and concern and were often heartened by her enthusiasm. Ann Grogg and Marjorie Anderson, freelance development editors, also provided many insights. Margaret Comaskey, project editor, was invaluable in the final stages of the project. Shannon Capanna and Jordan Scott provided very able research assistance. We are grateful to them all.

We also want to thank our families. It is they who have had to live with this project as long as we have. They have all put up cheerfully with this invasion into their lives. We love them.



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A Special Note to Students

“Life ain’t going to be like anything you ever heard of before.”¹ Forecasting is tricky business, but this statement strikes us as being as safe a bet as one can make in anticipating the changes that lie ahead, the changes we all will face. Change—rapid change—underlies all our lives.

However rapid the change, though, the principles of economics that you will learn in this book will help you to understand it. You’ll learn an approach to thinking about choices that is likely to be quite different from any you’ve encountered before. But we think you’ll find that this approach will be useful to you in all sorts of ways:

In Your Daily Life Life is a series of choices, and economics is the study of choice. As you learn about economics, you’ll learn a framework for decisionmaking that applies to choosing whether to pay cash or use a credit card, how to evaluate a financial investment, or what to do this weekend.

In Your Campus Life Should you buy your texts in the campus bookstore or online? How should you choose between riding the bus or driving your car to school? Should you park in the prime (and often expensive) lot or in the shuttle lot away from campus? What factors should you consider in choosing a major? This course won’t give you answers to these questions, but it will give you a useful vantage point from which to consider the alternatives.

In Your Career Whatever career you choose, your study of economics will help you. It won’t pick out a career for you, but it will give you a framework for thinking about choosing one. And, once you’ve chosen a career, application of the economic principles you’ll learn will make you more successful in it.

In Your Political Life As a participant in the political process, you will be expected to take positions on all sorts of issues. Should there be an increase in the minimum wage? Should universities have different entrance standards for different groups? Should producers be protected from foreign competition? You will want to know how such policies are likely to affect you and your fellow citizens. The economic principles you study in this course will give you insights that will help you form reasoned positions on these and a wide range of other issues.

These are ambitious goals, and we’ve set them with you in mind. We want you to share our excitement about economics and its power to frame your choices in a way that will make those choices better ones. We want to help you prepare for a life about which the only thing we know for certain is that it will be full of change.

¹Lane Kirkland, former president of the AFL-CIO used this line in a commencement address to the University of South Carolina in 1985. He was paraphrasing a line from the western movie, *Missouri Breaks*.

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