

# THE MICRO ECONOMY TODAY

C 2  
\$2330

Fifth Edition

Bradley R. Schiller

NEW BC





# **THE MICRO ECONOMY TODAY**

Fifth Edition

**Bradley R. Schiller**  
The American University

**McGraw-Hill, Inc.**

New York St. Louis San Francisco Auckland Bogotá  
Caracas Lisbon London Madrid Mexico Milan  
Montreal New Delhi Paris San Juan Singapore  
Sydney Tokyo Toronto

**THE MICRO ECONOMY TODAY**

Copyright © 1991, 1989, 1986, 1983, 1980 by McGraw-Hill, Inc. All rights reserved.  
Printed in the United States of America. Except as permitted under the United States Copyright Act of 1976,  
no part of this publication may be reproduced or distributed in any form or by any means,  
or stored in a data base or retrieval system, without the prior written permission of the publisher.

2 3 4 5 6 7 8 9 0 DOW DOW 9 5 4 3 2 1

ISBN 0-07-056170-2

This book was set in Cheltenham Book by Waldman Graphics, Inc.  
The editors were Scott D. Stratford, James A. Bittker and Elaine Rosenberg;  
the designer was Charles A. Carson;  
the production supervisor was Leroy A. Young.  
R. R. Donnelley & Sons Company was printer and binder.

Library of Congress Cataloging-in-Publication Data

Schiller, Bradley R., (date).

The micro economy today / Bradley R. Schiller.—5th ed.

p. cm.

Includes index.

ISBN 0-07-056170-2

1. Microeconomics. I. Title.

HB172.S3625 1991

338.5—dc20

90-22626

# P R E F A C E

*The* economy today doesn't stand still. Within a year of publication of *The Micro Economy Today's* fourth edition, the foundations of communism began to tremble. By the time most students got to the chapter on socialist planning, central planners were looking for new jobs. And teachers of introductory economics were looking for new textbooks. Today's students want explanations for the collapse of communism. They are newly motivated to understand how the "invisible hand" of the marketplace works and why central planners look with envy at its efficiency. This changing world requires a new approach to economics, going "back to basics" and highlighting the comparative appeal of free markets.

The collapse of communism was not the only headline story of recent years. The financial markets have also figured prominently in the news. First there was the crash of 1987. Then came the tremor of October 13, 1989, which sent the Dow Jones Industrial Average plunging 190 points. In 1990 the Japanese stock market also took a tumble, dropping more than 40 percent. Continuing volatility along with insider trading scandals raise basic concerns about the stability and integrity of all financial markets. The growth of the financial services sector, together with the central role of financial markets in allocating resources, makes these concerns important *economic* issues that can no longer be ignored in a principles course.

This fifth edition of *The Micro Economy Today* responds fully to these challenges. Both the appeal and the shortcomings of central planning are vividly assessed in a new chapter on the collapse of communism. Market and command economies are compared throughout the text, in areas as diverse as commodity pricing, labor relations, environmental protection, and trade. These perspectives are reinforced with a basic issue that recurs through the entire text, namely, the alternate risks of *market failure* and *government failure*. This same theme is apparent in the new chapter on financial markets, which focuses on the economic functions of stock, bond, and futures markets.

*The Micro Economy Today* doesn't just follow the headlines. Pedagogy changes as well. We all try to make every lecture a little better, every test a bit more discriminating. The fifth edition strives for the same kinds of improvement. *The Micro Economy Today* seeks to make the study of economics as dynamic and exciting as the world economy itself.

## PRODUCT DIFFERENTIATION

---

What most clearly differentiates *The Micro Economy Today* from other texts are the following features.

**Global Vision** To understand economics today, students must learn to think in global terms. In *The Micro Economy Today* this global vision is manifest in

**World views** Interspersed throughout the text are boxed illustrations of economic issues in a global setting. Many of the World Views offer comparative perspectives on key economic indices (e.g., debt, advertising outlays, labor productivity). Others provide current or historical illustrations of core ideas (e.g., the role of markets in financing Columbus's voyages, the role of central planning in creating a shortage of soap in the Soviet Union). All World View boxes have a distinctive logo and light blue background (e.g., see p. 17) and are explicitly referenced in the body of the text.

## Real-World Relevance

The global vision of *The Micro Economy Today* is an integral part of the “real world.” In addition to international illustrations, the relevance of economic principles is demonstrated through examples of today's policy debates, current institutional structures, and real firms and industries.

**Actual case studies** Fanciful stories about widget production won't motivate students who are mastering high-tech and wondering how software prices are determined; the real-life applications of economic principles featured in *The Micro Economy Today* will. The evolution of the personal computer industry (Chapters 7–9) is a classic illustration of (changing) industrial structure. The product- and firm-specific concentration data in Table 10.2 (p. 264) contrast sharply with the more generalized (and therefore less meaningful) industry data provided in other texts. The new discussion of cable TV is the basis for a revised discussion of natural monopoly and government regulation (Chapter 11). Every chapter of *The Micro Economy Today* conveys the conviction that economic principles are important and relevant to what's happening in the world today.

**In the news** This second set of boxes has its own distinctive logo and design; thus each box is instantly distinguished from World Views and the body of the text (e.g., see p. 4). The purpose of these brief news stories is to illustrate specific principles while underscoring the real-world relevance of economic theory. In the News applications are explicitly referenced in the body of the text and are often the subject of questions at the end of a chapter or in the accompanying *Study Guide*. In the brief period between the last edition and this, nearly half of the In the News and World View boxes were replaced or updated.

**Policy insights** Every chapter in the theory sequence includes a final section on Policy Insights. These sections, identified by a distinctive red banner, apply basic principles to actual policy issues. These applications test student ability to think critically about the relevance and validity of economic concepts.

## Hot Issues

Given the real-world orientation of this text, readers can expect the most widely discussed issues of the 1990s to command substantial attention. They won't be disappointed. Among the “hot issues” are:

**The collapse of communism** The emerging transition from “command-driven” to “demand-driven” economies in Eastern Europe, the Soviet Union, and China is the most significant economic event of the 1990s. Two years ago this cataclysmic change was unforeseen; today everyone is trying to explain it. *The Micro Economy Today* offers a new chapter that looks at the promise of communism, the defects of central planning, and the continuing difficulties

of the transition to freer markets. Chapter 23 explains these revolutionary changes succinctly and contrasts market and centrally planned economies perceptively. Many instructors may want to assign this chapter immediately after Chapter 2, thereby highlighting the unique (but often mysterious) character of the market mechanism.

Discussion of the collapse of communism is not confined to Chapter 23. The contrast of East German prices and West German prices at the time the Berlin Wall was dismantled introduces the basics of supply and demand (Chapter 2). The resultant shifts in the demand and supply of Deutsche marks and Ostmarks are a good starting point for consideration of foreign-exchange markets (Chapter 21). The pervasive neglect of environmental protection in Eastern Europe illustrates the tradeoffs inherent in pollution control (Chapter 12). And the long line of eager job applicants at McDonald's new Pushkin Square outlet demonstrates basic principles of labor supply (Chapter 14).

**The cold war peace dividend** The collapse of communism has led to a worldwide reassessment of the "guns vs. butter" decision. As the cold war dwindles, demands for a military build-down intensify. The resulting "peace dividend" will create unparalleled opportunities for new investment, consumption, or other (nonmilitary) public-sector activity. David Wyss of Data Resources, Inc., developed expressly for *The Micro Economy Today* some illustrative estimates of the actual terms of the guns vs. butter tradeoff (see p. 7).

**Financial markets** One of the fastest growing sectors of the global economy is financial services. Yet introductory courses, following the cursory descriptions of corporate structure, stock market averages, and stock market quotations of other textbooks, have largely ignored this industry. *The Micro Economy Today* offers a more compelling alternative. Chapter 19 emphasizes the basic *economic* functions of the financial markets in mobilizing and allocating real resources. Illustrations include the financing of Columbus's exploration, the new EuroDisney World outside of Paris, and the new interest expressed in the Soviet Union and Eastern Europe in this fundamental tool of capitalism.

In addition to this chapter-length treatment of financial markets, a brief discussion of venture capitalism is included in Chapter 16, Rent, Interest, and Profit. This particular Policy Insight emphasizes the relation between risk and profit as well as the role of venture capitalists in resource allocation.

**Environmental protection** Concerns about the earth's warming, ozone depletion, toxic wastes, and other environmental damages affect the way we live and conduct business. The Clean Air Act amendments of 1990 stipulate substantial behavioral changes in the years ahead. To comprehend these changes, students need to understand both the consequences of pollution and the costs of environmental protection. Chapter 12 provides this perspective as it seeks to illustrate the core problem of externalities and to develop the concept of *optimal* pollution.

**Government failure vs. market failure** Environmental protection is just one dimension of a much broader issue. At the core of most policy debates is the question of market failure. If unregulated markets always generated the optimal mix of output, full employment, and an equitable distribution of income, there would be no need for government intervention. In reality, of course, markets do fail and the government is called upon to move the economy closer to desired outcomes.

But does government intervention succeed? Does intervention move us closer to the optimal mix of output or the optimal distribution of income? If not, government intervention fails as well. In the real world, the choice is not between imperfect markets and perfect intervention, but between imperfect markets and imperfect policies. The nature and cost of these real-world choices is a unifying theme throughout *The Micro Economy Today*.

### Careful Pedagogy

Economic principles were put to use in designing *The Micro Economy Today*. The opportunity cost of trying to cover everything was crystal clear. Encyclopedic texts leave the average student floundering. The choice made here was to cover less material but cover it thoroughly. The emphasis is on step-by-step development of core concepts, with a generous dose of real-world illustrations.

The emphasis on *teaching* basic principles is evident in an assortment of pedagogical features, including

- **Clear Graphs** All of the graphs are clearly labeled, fully annotated, and highlighted with colors. The time dimension is always included when *flows* are being examined.
- **Annotated Tables** This shouldn't be a differentiating feature but it still is. All of the tables in *The Micro Economy Today* include self-contained explanations.
- **Running and Repeated Glossary** Most other texts have now adopted *The Micro Economy Today's* pioneering in-margin glossary. This remains, however, the only text that *repeats* in-margin definitions in subsequent chapters. Unfortunately, few people grasp and retain core concepts after only one exposure. *The Micro Economy Today* recognizes this real-world limitation and offers students some additional support. Learning and retention are further encouraged by end-of-chapter key-term reviews and a complete glossary (with chapter references) at the end of the book.
- **Motivating Questions** Every chapter starts out with a few questions to pique student interest. A brief introduction highlights the general coverage of the chapter. This is followed by key questions, which forge a direct link between the introductory illustration and the core objectives of the chapter.

### Lively Style

Pedagogy is more than just technique and organization. Style is also important. Dull writing dulls the learning process. The *motivation* to learn must be reinforced with interesting examples, sharp wit, and clever phrases. This isn't a novel, but it is a very readable economics text—students actually *enjoy* it.

## MICRO HIGHLIGHTS

---

*The Micro Economy Today* has been revised extensively. The major revisions include a strengthening of the introduction to supply and demand (Chapters 2 and 4), a reconfiguration of the basic theory of the firm sequence (especially Chapters 6 and 7), an expansion of the discussion of antitrust and regulation (Chapters 10 and 11), a consolidation of the labor chapters (Chapter 14), and new discussions of financial markets (Chapters 16 and 19).

**Competitive firms and industries** The traditional chapter on competitive behavior has been expanded to two chapters. Chapter 6 focuses on the competitive *firm*, showing how it makes production, shutdown, and investment decisions. Chapter 7 focuses on a competitive *industry*, emphasizing the role of entry and exit in changing market outcomes. This extended treatment should help students grasp the unique characteristics of both competitive firms and the market (industry) environment in which they function. Explicit contrasts to the behavior and outcomes of monopoly and other industry structures are provided in subsequent chapters (e.g., see p. 237). Contrasts with centrally planned economies are also included (e.g., see World View on p. 203).

**Antitrust and regulation** The antitrust and regulatory discussions have been placed in sequence (Chapters 10 and 11) and expanded. The antitrust discussion makes a sharp distinction between market *structure* and *behavior* and introduces the Herfindahl-Hirshman Index as a pragmatic guide to anti-trust policy. The chapter on regulation begins with a review of the sources of market failure, then focuses on the unique regulatory choices posed by natural monopoly. The cable TV industry and World Views on European and Japanese telephone monopolies enliven the discussion.

**Consolidated labor sequence** This edition combines the discussions of labor supply and demand into a single chapter (Chapter 14). The new labor market chapter provides a capsule explanation of labor supply, based on substitution and income effects, and a longer discussion of labor demand. The impacts of new minimum wage rates and the influx of immigrants into American and Western labor markets are examined.

**Risk and entrepreneurship** Rather than take risk and entrepreneurship for granted, *The Micro Economy Today* emphasizes their critical role in allocating resources, innovating new products, and expanding our production possibilities. This greater visibility is apparent in Chapter 16, Rent, Interest, and Profit (including a discussion of venture capitalism); Chapter 17, Taxes and Inequality (including the pros and cons of a capital gains tax cut); and the all-new Chapter 19, Financial Markets. The failure of centrally planned economies to exploit the power of entrepreneurship is discussed in Chapter 23.

## INTERNATIONAL HIGHLIGHTS

---

The global vision that epitomizes *The Micro Economy Today* is apparent throughout the text. The final four chapters, however, focus exclusively on international topics. In this revision, highlights for these chapters include

**United States as a net debtor** In 1987 the international position of the United States was reversed, making this country a net debtor in the world economy. This change in investment flows has been accompanied by increasing anxiety over foreign investments in the United States. Indeed, in a recent Harris poll for *Business Week*, two out of three Americans said they expected foreign companies to dominate the American economy in the 1990s. These concerns are addressed in Chapters 20 and 21. In addition to developing and illustrating basic trade and finance theories, these chapters discuss the competing interests that seek to alter trade and finance outcomes.



**Eastern Europe and Third World development** The consequences of slow growth became apparent when the Iron Curtain was dismantled. Like the Third World, the countries of Eastern and Central Europe are desperately seeking mechanisms that will accelerate growth. Although Eastern Europe enjoys much higher living standards than the Third World, both groups of nations face common obstacles (e.g., bloated state enterprises, weak currencies, consumer subsidies, and high debt). Chapter 22 examines these common growth barriers and alternative strategies for overcoming them.

**Collapse of Communism** The final chapter provides a cautious, analytical assessment of the revolutionary changes taking place in the Eastern bloc. In addition to spotlighting the defects of central planning, Chapter 23 emphasizes the political, social, and economic forces that are setting the pace of transition. Examples are drawn from Eastern Europe, the Soviet Union, China, and Cuba. The chapter was designed for use either as a capstone to the micro sequence or, alternatively, as an earlier contrast to the robustness of the market mechanism (e.g., after Chapter 2).

## PEDAGOGICAL HIGHLIGHTS

---

The fifth edition of *The Micro Economy Today* is a bit more rigorous than earlier editions. This added rigor has been made possible by the deletion or consolidation of secondary topics, with more space devoted to the development of basic principles. This is most evident in Chapters 2 and 4, the foundations of supply and demand. More visible revisions to the pedagogy include

- **Chapter-Opening Questions** As noted earlier, every chapter now starts with questions designed to guide and stimulate the learning process.
- **More End-of-Chapter Problems** Additional numerical problems have been included, giving instructors more choices of homework or in-class assignments. Answers to all problems are in the *Instructor's Manual*.
- **Greater Integration of Tables and Graphs** *The Micro Economy Today* was the first book to tie tables and related graphs closely together by synchronizing the labeling of table rows and points on corresponding graphs. The fifth edition takes this innovation a step further by incorporating more tables and graphs into the same figure (see, for example, p. 37).
- **Functional Use of Color** This is the first edition of *The Micro Economy Today* to be published in four colors. The goal of this “colorization” has been *functional*, not merely aesthetic. Consistent use of color screening and logos sets off key features (e.g., World Views). Consistency in the use of broken and smooth curves, together with color screening, highlights shifts of supply and demand curves (e.g., p. 128).
- **Integrating Theme** The various sections of the text are explicitly related to the overriding issue of government intervention. Can markets do the job? Or is government intervention needed? This broad issue is restated repeatedly throughout the text, giving students a consistent framework in which to learn and apply economic principles.
- **Critical Thinking** By confronting students with the recurrent use of market vs. government failure, *The Micro Economy Today* stimulates students to

apply economic principles. Rather than just memorizing terminology, students are encouraged to think critically about the use of economic theory in the world today.

## **A COMPLETE TEACHING AND LEARNING PACKAGE**

---

The various parts of the teaching and learning package to accompany *The Micro Economy Today* have been closely coordinated with one another and include a new and unique focus on critical thinking through reading newspapers and periodicals. In addition, painstaking efforts were made to keep *The Micro Economy Today* error-free, from beginning to end, with a consistency of style, level, and approach throughout the text.

## **STUDENT LEARNING AIDS**

---

**Study guide** Several supplements accompany the text. From the student's perspective, the most important of the supplements is the *Study Guide*, prepared by Professors Michael Tansey at Rockhurst College and Lawrence Ziegler at the University of Texas (Arlington). There is a full-text *Study Guide* and, once again, macro and micro versions are also available. The *Study Guide* develops skills in mathematics and the use of economic terminology and enhances critical thinking capabilities. Each chapter of the *Study Guide* contains these features:

**QUICK REVIEW** Key points in the text chapter are restated at the beginning of each *Study Guide* chapter. The reviews are parallel to and reinforce the chapter summaries provided in the text.

**LEARNING OBJECTIVES** The salient lessons of the text chapters are noted at the outset of each *Study Guide* chapter. These objectives focus the student's study and help to ensure that key points will not be overlooked. The objectives are keyed to the exercises in the *Study Guide* to help reinforce learning.

**KEY-TERM REVIEW** Early in each chapter the students are asked to match definitions with key terms. This relatively simple exercise is designed to refresh the student's memory and provide a basis for subsequent exercises.

**TRUE-FALSE QUESTIONS** Twenty or so true-false questions are provided in each chapter. These questions have been class tested to ensure their effectiveness in highlighting basic principles.

**MULTIPLE-CHOICE QUESTIONS** Approximately fifteen multiple-choice questions per chapter are provided. These questions allow only one correct answer and also focus on basic principles.

**PROBLEMS AND APPLICATIONS** There are more than twenty exercises in the micro version of the *Study Guide*, most of which stress current issues and events.

**MEDIA ASSIGNMENTS** Refined from the previous edition and with extensive classroom testing, media assignments have been included for most chapters in the textbook. Each assignment requires the student to find and copy a newspaper or magazine article, and then underline a few words that illustrate the required economic idea. Because each assignment is carefully and pre-

cisely specified following an example provided in the *Study Guide*, the assignments require a minimum of explanation, and grading is fast and easy.

**COMMON ERRORS** In each chapter of the *Study Guide*, errors that students frequently make are identified. The bases for those errors are then explained, along with the correct principles. This unique feature is very effective in helping students discover their own mistakes.

**ANSWERS** Answers to *all* problems, exercises, and questions are provided at the end of each chapter. Difficult problems have annotated answers. These answers make the *Study Guide* self-contained, thus allowing students to use it for self-study.

**Student software** For those interested in computer-assisted instruction, several economic software programs are available.

**INTERACTIVE GRAPHICS TUTORIAL II** Interactive Graphics Tutorial II is an upgraded version of McGraw-Hill's very successful economics software program developed by H. Scott Bierman at Carlton College and Todd Proebsting (University of Wisconsin). Thousands of students have used the Interactive Graphics Tutorial to learn, understand, and reinforce their study of economic graphics. This updated and technically advanced version includes microcomputer simulations.

**GRAPHICS TUTOR** The Graphics Tutor is available in three packages: microeconomics, macroeconomics, and principles of economics. Each package presents tutorials that help students learn fundamental ideas in economics through the extensive and dynamic use of graphs.

**VIZECON** For users of Macintosh computers, there is an exciting new tutorial program, *VizEcon*. Developed by Professor William A. Phillips at the University of Southern Maine, this innovative package uses Apple's HYPERCARD programming environment to produce an extremely interactive learning experience. Dynamic shifts of curves, screen animation, sound effects, and simple-to-use command keys are features of this program. Its development was underwritten by grant funds and consultation from Apple Computer Inc.

### **Instructor Teaching Aids**

Why not try to make the learning process easier for teachers as well as students? To this end, the teaching package includes several items valued by instructors:

**News flashes** As up-to-date as *The Micro Economy Today* is, it can't foretell the future. As the future becomes the present, however, Bradley Schiller writes News Flashes describing major economic events and relating them to specific text references. For this edition, adopters of *The Micro Economy Today* have the option of receiving News Flashes nearly instantaneously via FAX. Four to Six News Flashes are sent to adopters each year.

**Instructor's resource manual** Donald Pearson at Eastern Michigan University has fully revised his *Instructor's Resource Manual* for this edition, with new sections designed to make the text more effective and easier to use. It has several innovations. First, an introductory chapter is devoted entirely to instructional tools and contains references to instructional handbooks, workbooks, newspapers, magazines, student subscription programs, and customized readings. Second, a chapter-by-chapter review of the text provides tools,

suggestions, and hints for effective use of classroom time devoted to each chapter. Features include

**CONTENTS IN BRIEF** A brief outline gives a quick overview of the chapter.

**WHAT IS THIS CHAPTER ALL ABOUT?** New and unique features of each chapter are explained and key critical thinking goals are stressed.

**LECTURE SUGGESTIONS** General suggestions for the direction lectures might take and one or more *lecture launchers* for introducing the material are offered.

**SOME COMMON PROBLEMS** Topics in each chapter which tend to be problematic for students are reviewed. The section has drawn on the expertise of instructors who have used previous editions of the text in both small classes and large lectures.

**ANNOTATED CONTENTS IN DETAIL** An outline of the text chapter is completely annotated. It can be used for building lectures or it can be distributed to students as a study guide.

**TAKE A STAND** A controversial question is posed about one issue in the chapter which is illustrated by either an In the News or World View box. The question is followed by one paragraph in support of the issue and one paragraph in opposition. No resolution of the issue is offered. Take a Stand is intended to motivate classroom discussion or to form the basis for essay questions.

**QUESTIONS FOR DISCUSSION** The questions from the end of the text chapter are repeated and answers or guidelines for answers are provided to all questions.

**ANSWERS TO PROBLEMS** Here you will find the answers to problems at the end of the text chapters.

**SUPPLEMENTARY RESOURCES** This final section provides two kinds of information. First, it contains annotated references of videotapes or films relevant to the text chapter. Second, it contains a brief bibliography of articles and books that can be used for additional reading assignments or suggestions for students. These also provide a quick guide of sources to use for expanding lecture materials.

**MEDIA EXERCISES** These tear-out assignments require the student to find an example from the media to illustrate an economic concept. There is approximately one per chapter. After each exercise, professor's notes and lecture opportunities are provided.

**Test bank** The Test Bank to accompany *The Micro Economy Today* follows the lead of the textbook in its application of economic concepts to worldwide economic issues, current real-world examples, and the role of government in the economy. Now prepared by the *Study Guide* authors, Michael Tansey and Lawrence Ziegler, together with Bruce Kelley at Florida International University, the Test Bank has been significantly strengthened. The new authorship team helps assure not only a high level of quality and consistency of the test questions, but the fullest possible correlation with the content of the text and *Study Guide*. The Test Bank will be published in two separate volumes, each with over 3,000 objective, predominantly multiple-choice,



questions; either volume can be used to construct tests to cover all the material in a chapter.

**Computerized testing** Computerized versions of the Test Bank are available for both IBM-PC computers and compatibles and Macintosh computers. The programs allow instructors to view, edit, and test questions to create exams.

**Customized test** Instructors may have tests custom prepared by the publisher by calling the publisher's special test service. Masters prepared from the Test Bank will be mailed out within seventy-two hours.

**Overhead Transparencies** One hundred of the key tables and graphs in the text have been reproduced as full-color overhead transparency acetates. These are made available to adopters by the publisher.

## ACKNOWLEDGMENTS

---

*The Micro Economy Today* continues to benefit from the advice and suggestions of users and reviewers. I am particularly grateful to those individuals who scrutinized the fourth edition or reviewed drafts of this fifth edition. With my profound appreciation for their contributions, I thank

**Thomas Anderson**

Montgomery Community College

**Masato Aoki**

University of Massachusetts at Amherst

**John Azer**

Normandale Community College

**Andrew Barnett**

Auburn University

**Erwin Blackstone**

Temple University

**Wallace Broome**

Community College of Rhode Island

**E. Ray Canterbury**

Florida State University

**Basil Cooil**

Tompkins Cortland Community College

**Duane Eberhardt**

Missouri Southern State College

**Ray Egan**

Pierce College

**John Farrell**

Oregon State University

**John Fizel**

Pennsylvania State University-Erie

**Roger Frantz**

San Diego State University

**Carl Guelzo**

Catonsville Community College

**Robert Harris**

Economics Consultant to the  
Superintendent of Education in  
California

**Elizabeth Hill**

Pennsylvania State University-  
Mont Alto

**Christopher Inya**

Monroe Community College

**Walter Johnson**

University of Missouri

**M. W. Keil**

Northeastern University

**Bruce Kelley**

Florida International University

**William Kerby**

California State University-Sacramento

**Stephen E. Lile**

Western Kentucky University

**W. L. Loh**

Mohawk Valley Community College

**Carol McDonough**

University of Lowell

**Farhang Niroomand**

University of Southern Mississippi

**John Pearce**

North Georgia College

**Donald Pearson**

Eastern Michigan University

**Ronald Schuelke**  
Santa Rosa Junior College

**Augustus Shakelford**  
El Camino College

**Marsha Shelburn**  
University of South Carolina at Aiken

**Dorothy Siden**  
Salem State College

**Larry Singell**  
University of Colorado–Boulder

**Donald Smith**  
Boston University

**Gary Sorenson**  
Oregon State University

**Richard Spivack**  
Bryant College

**Michael M. Tansey**  
Rockhurst College

**Peter Turner**  
Herkimer County Community College

**Jack Wegman**  
Santa Rosa Junior College

**William Zeis**  
Bucks County Community College

**Lawrence F. Ziegler**  
University of Texas at Arlington

**Publishing Team** This is the first edition of *The Micro Economy Today* to be published by McGraw-Hill, which, I was told, acquired the Random House college division just to get this text. I don't believe that, but have been very impressed by the care and attention McGraw-Hill has devoted to this book. Jim Bittker in particular has been instrumental in generating ideas, mobilizing reviewers and resources, and attending to the quality and timeliness of every stage of production. Editing Supervisor Elaine Rosenberg kept the project rolling and made sure I didn't take any days off. Chuck Carson created a distinctive cover and text design. Leroy Young oversaw the production process. Lastly, thanks are due to Carole Schwager, copy editor, for her meticulous work on both the text and Study Guide.

**Personals** Thanks again to Tricia, Justin, and Ashley, who helped me in many tangible ways and inspired me in countless intangible ways.

*Bradley R. Schiller*

# CONTENTS IN BRIEF

<b>Preface</b>	<b>xvii</b>	<b>Chapter 13 The Farm Problem</b>	<b>333</b>
<b>SECTION I: BASICS</b>	<b>1</b>	<b>PART C: FACTOR MARKETS: BASIC THEORY</b>	<b>351</b>
Chapter 1 An Overview	3	Chapter 14 The Labor Market	353
Appendix: Using Graphs	25	Chapter 15 Power in Labor Markets	379
Chapter 2 Supply and Demand	31	Chapter 16 Rent, Interest, and Profit	401
Chapter 3 The Public Sector	59	<b>PART D: FACTOR MARKETS: ISSUES</b>	<b>417</b>
<b>SECTION II: MICROECONOMICS</b>	<b>85</b>	Chapter 17 Taxes: Equity v. Efficiency	419
<b>PART A: PRODUCT MARKETS: BASIC THEORY</b>	<b>87</b>	Chapter 18 Work vs. Welfare	437
Chapter 4 The Demand for Goods	89	Chapter 19 Financial Markets	451
Appendix: Indifference Curves	116	<b>SECTION III: INTERNATIONAL ECONOMICS AND COMPARATIVE SYSTEMS</b>	<b>475</b>
Chapter 5 The Costs of Production	125	Chapter 20 International Trade	477
Chapter 6 The Competitive Firm	153	Chapter 21 International Finance	509
Chapter 7 Competitive Markets	181	Chapter 22 International Development	531
Chapter 8 Monopoly	207	Chapter 23 The Collapse of Communism	553
Chapter 9 Imperfect Competition	235		
<b>PART B: PRODUCT MARKETS: ISSUES</b>	<b>259</b>		
Chapter 10 Market Power and Antitrust	261		
Chapter 11 (De)Regulation of Business	285		
Chapter 12 Environmental Protection	307		

# C O N T E N T S

## Preface xvii

## SECTION I : BASICS 1

### Chapter 1 An Overview 3

#### The Economy Is Us 4

#### The Nature of Economic Choice 6

Opportunity Costs 6

#### Production Possibilities 8

Increasing Opportunity Costs 10 • Points inside and outside the Curve 13 • Growth and Technology 14

#### How Choices Are Made 15

The Market Mechanism 15 • Command Economies 16 • Market Imperfections 17 • Mixed Economies 18

#### What Economics Is All about 19

End vs. Means 19 • Macro vs. Micro 20 • Theory and Reality 21 • Policy 21 • Controversy 22 • Modest Expectations 23

#### Summary 23

World View:

Where Communist Economies Fell Short 17

In the News:

Worried about Wealth 4 • The Peace Dividend 7

#### Appendix: Using Graphs 25

Slopes 26 • Shifts 27 • Linear vs. Nonlinear Curves 28 • Causation 29

### Chapter 2 Supply and Demand 31

#### Market Participants 32

Goals 32 • Constraints 33 • Specialization and Exchange 33

#### Market Interactions 33

The Two Markets 34 • Dollars and Exchange 35 • Supply and Demand 36

#### Demand 36

Individual Demand 36 • Determinants of Demand 38 • *Ceteris Paribus* 39 • Shifts in Demand 39 • Movements vs. Shifts 40 • Market Demand 40 • The Market Demand Curve 41

#### Supply 43

Determinants of Supply 43 • The Market Supply Curve 44 • Shifts in Supply 45

#### Equilibrium 45

Surplus and Shortage 46 • Changes in Equilibrium 49

#### Disequilibrium Pricing 50

Price Ceilings 50 • Price Floors 52

## Policy Insights: Laissez Faire 54

What, How, For Whom 55 • Optimal, Not Perfect 55

## Summary 56

World View:

Dining on the Downtick 51 • Fed up with the Food Fight 53

In the News:

Typing Services 43 • Condo Prices in New York 46 • Surplus Punches Hole in Oil Price 48 • U2 Fans and the Longest Five Days 48

### Chapter 3 The Public Sector 59

#### Micro Failure 60

Public Goods 60 • Externalities 62 • Market Power 64 • Equity 65

#### Macro Failure 65

#### Growth of Government 66

Federal Growth 66 • State and Local Growth 67

#### Government Spending 68

The Federal Budget 69 • Expenditures on Goods and Services 69 • Income Transfers 70 • Interest 71 • State and Local Spending 71

#### Taxation 72

Federal Taxes 72 • State and Local Revenues 74

#### Policy Insights: Government Failure? 76

Perceptions of Waste 77 • Opportunity Costs 77 • Public Choice 79

#### Summary 82

World View:

Public-Sector Spending 68

In the News:

Beverly Hills Outlaws Smoking in Restaurants 63 • Some Taxing Facts about Lotteries 75 • Rising Doubts about Government Waste 76 • A Sampling of 1988–1989 State Referendums 80

## SECTION II : MICROECONOMICS 85

### PART A: PRODUCT MARKETS: BASIC THEORY 87

### Chapter 4 The Demand for Goods 89

#### Patterns of Consumption 89

#### Determinants of Demand 90

The Sociopsychiatric Explanation 90 • The Economic Explanation 91



## **The Demand Curve 93**

Utility Theory 93 • Price and Quantity 95

## **Price Elasticity 96**

Computing Price Elasticity 97 • Price Elasticity and Total Revenue 99 • Determinants of Elasticity 101

## **Other Elasticities 103**

Shifts vs. Movements 103 • Income Elasticity 103 • Cross-Price Elasticity 106

## **Choosing among Products 107**

Marginal Utility vs. Price 108 • Utility Maximization 108 • Utility-Maximizing Rule 110

## **Policy Insights: Caveat Emptor 481**

Are Wants Created? 113

## **Summary 114**

World View:

Curbing Smoking 97 • Where the Pitch Is Loudest 112

In the News:

Men vs. Women: How They Spend 91 • Raising the D.C. Gas Tax: A Lesson in Elasticity 104 • CDs Displace LPs 107 • Miller Lite: An Advertising Success 113 • The New Coke: An Advertising Flop 113

## **Appendix: Indifference Curves 116**

### **Constructing an Indifference Curve 117**

An Indifference Map 118

### **Utility Maximization 119**

The Budget Constraint 120 • Optimal Consumption 120 • Marginal Utility and Price: A Digression 121

### **Deriving the Demand Curve 122**

The Demand Schedule and Curve 124

## **Chapter 5**

## **The Costs of Production 125**

### **The Production Function 125**

Efficiency 127 • Short-Run Constraints 125 • Marginal Productivity 129 • Diminishing Returns 131

### **Resource Costs 131**

Marginal Cost 132

### **Dollar Costs 133**

Total Cost 134 • Average Costs 136 • Marginal Cost 139 • A Cost Summary 140

### **Economic vs. Accounting Costs 142**

Economic Cost 143

### **Long-Run Costs 143**

Long-Run Average Costs 144 • Long-Run Marginal Costs 145

### **Economies of Scale 145**

### **Policy Insights: Productivity**

Improvements 148

### **Summary 149**

World View:

Unit Labor Costs 136

In the News:

Some Firms Fight Ills of Bigness by Keeping Employee Units Small 147 • R&D Spending in 1988 149

## **Chapter 6**

## **The Competitive Firm 153**

### **The Profit Motive 153**

Other Motivations 154

### **Economic vs. Accounting Profits 154**

Economic Profits 156 • Entrepreneurship 158 • Risk 158

### **The Nature of Competition 159**

Price Takers 159 • Market Demand Curves vs. Firm Demand Curves 160

### **The Production Decision 161**

Output and Revenues 161 • Output and Costs 162

### **Profit-Maximizing Rule 164**

Marginal Revenue = Price 164 • Marginal Cost 165 • Profit-Maximizing Rate of Output 166 • Adding up Profits 168

### **The Shutdown Decision 170**

Price vs. AVC 171 • The Shutdown Point 172

### **The Investment Decision 172**

Long-Run Costs 173

### **Determinants of Supply 173**

Short-Run Determinants 174 • Supply Shifts 175

### **Policy Insights: Taxing Business 175**

Property Taxes 176 • Payroll Taxes 177 • Profit Taxes 177

### **Summary 177**

World View:

Volkswagen to Close Only U.S. Plant 172

In the News:

Are Money and Status Losing Their Allure? 155

## **Chapter 7 Competitive Markets 181**

### **Firm vs. Market Supply 181**

Entry and Exit 182 • Tendency toward Zero Profits 182 • Low Barriers to Entry 185 • Market Characteristics 185

### **Competition at Work: Microcomputers 186**

Initial Conditions: The Apple I 187 • The Production Decision 187 • Profit Calculations 189 • The Lure of Profits 190 • Low Entry Barriers 190 • A Shift of Market Supply 191 • Home Computers vs. Personal Computers 194 • Price Competition in Home Computers 195 • Further Supply Shifts 196 • Shutdowns 197 • Exits 198 • The Personal Computer Market 198

### **Reflections on the Competitive Process 198**

The Relentless Profit Squeeze 199 • The Social Value of Losses 201 • Competitive Efficiency 202

### **Policy Insights: Competitive Market**

Efficiency 203

### **Summary 204**