Economics

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Preface

We live in a rapidly changing world. In the last decade or so the Berlin Wall has fallen and the political map of Eastern Europe has been transformed. Russia remains in deep crisis. Western European integration has moved so rapidly during that time that many Western European countries are embracing a single currency. Many high-growth Asian economies, including Japan, have, in the last year or two, experienced the severest recession since the 1930s and sharp falls in their exchange rates. The US economy has boomed whilst much of Europe has struggled out of a deep recession. What are the forces that shape such events?

We have produced *Economics* specifically for students in Europe. Our aim is not primarily to describe the economic landscape but rather to explain and analyse the processes which will enable students to understand recent events and those which will happen as the early years of the new century unfold. Each chapter deals with an area of economic analysis which is liberally illustrated with relevant examples supported in almost every chapter by applications from other parts of the world.

The result, we hope, is a highly readable first-level text that students will keep on their shelves and use throughout their academic course and beyond.

The plan of the book

The purpose of the book is to introduce the discipline of economics and to provide a basic understanding of how economies function. This requires a blend of economic theory, institutional material, and real-world applications. We have tried to maintain a reasonable balance between these ingredients in every chapter in this book. We have also attempted to present differing theoretical views in an even-handed way.

While we have chosen to present microeconomics first, we have designed the text so that teachers may proceed directly to macroeconomics after teaching the five introductory chapters.

Microeconomics

The organisation of the microeconomic material reflects our belief that the best way to understand how market economies operate – and the best way to understand basic economic theory – is to work through the perfectly competitive model first, including discussions of output *and* input markets and the connections between them, before turning to non-competitive market structures. When students understand how a simple competitive system works, they can start thinking about how the pieces of the economy 'fit together'. We think this is a better approach to teaching economics than some of the more traditional approaches, which encourage students to think of economics as a series of disconnected alternative market models.

We therefore open with a chapter on the methodology of economics and proceed in chapter 2 to explain the nature of the economic problem – scarcity of resources. Then, following a chapter reviewing the European economy today, we explain in chapters 4 and 5 the determination of prices in competitive markets. Chapters 6–11 build on this foundation, examining the behaviour of both consumers and competitive firms in output and resource markets.

Looking at competition first allows students to see the power of the market system. It is impossible to discuss the things that markets do well until students have seen how a simple system determines the allocation of resources.

Chapter 12 is a pivotal chapter that links the world of perfect competition with the imperfect world of non-competitive markets, externalities, imperfect information, and poverty, all of which are subsequently discussed in more detail.

Chapters 13–14 concentrate on market failure due to monopoly power and chapter 15 examines government behaviour towards such power at both the national and European level. Chapter 16 examines more elements of market failure including externatlities, public goods and imperfect information. Markets give rise to an uneven distribution of income and this forms the focus of chapter 17.

In Chapters 18 and 19 students use much of what they have learned in chapters 6–17 to take a closer look at two of the fields of applied microeconomics (the economics of taxation and labour economics).

Macroeconomics

The macroeconomics section opens with three introductory chapters (chapters 20–22). These provide a first, bird's-eye perspective of the macroeconomy. Students are introduced to the tools of macroeconomics, including national income accounting. They are also familiarized with the major concerns of macroeconomics – inflation, income, growth, and unemployment – in the context of European experience.

After these chapters we assemble models – simplified pictures of reality – designed to help us understand, discuss and deal with macroeconomic issues. The crucial choice to be made here is whether to start with an analysis of the long-run features of the macroeconomy, or of its short-run behaviour. We opt for the latter, because this is where the action is: recessions, even major crises may appear small fare when looking back a few decades from now, but they do affect our current lives in dramatic ways.

Chapters 23–27 carve out a first model of the *global economy*. This helps understand the environment within which national economies operate, and has the pedagogical advantage of permitting us to leave out the complications that arise from the international linkages of modern economies.

From chapter 28 onward the focus is the *national economy*. Exports, imports, exchange rates and the balance of payments take centre stage. In chapter 30 we turn to the labour market, where wages are determined. Merging the labour market with the demand-side models of previous chapters displays the macroeconomic interaction between supply and demand. Taking this into account is essential for a full understanding of business cycles and related issues. Chapters 29 and 32 put the models to work: topics addressed there include the European Monetary System, European Monetary Union, inflation, central bank independence, unemployment, oil-price shocks, government budget deficits, the public debt, and budget control mechanisms such as the EU countries' Pact on Stability and Growth.

Chapters 33 and 34 may be skipped without losing track. Chapter 33 shows how to refine the basic model by means of more detailed modelling of firm and household behaviour. Chapter 34 sketches the different schools of thought that have contributed to today's understanding of the macroeconomy. It is emphasized that new directions in theoretical thinking are often triggered by new challenges which reality poses.

Chapter 35 turns to the long-run issues subsumed under the term 'economic growth'. It asks why some countries are rich while others remain poor, and why some countries' incomes grow rapidly while others' don't.

Much of the macroeconomics has been analysed in the context of an open economy but we return in chapter 36 to the underlying basis of international trade and explain more fully the law of comparative advantage first introduced in chapter 2. Chapter 37 deals with the problems of developing economies and their relationships with Europe. Finally, in chapter 38 we consider resource allocation in non-market economies and in those economies which are in transition to a market system.

Key features of the book

A European perspective

The book is truly European. First, we have introduced international economics early in macroeconomics. All European economies are critically dependent upon international trade. Second, the examples in the main text and in the boxes are drawn from all over Europe. In this way students start to understand how the main economic issues affect Europe, and become familiar with the major European currencies and the euro, which is rapidly becoming a key currency in international trading relationships.

Finally, there are many 'Global Perspective' boxes throughout the text. These boxes are designed to illustrate economic logic, with global examples from outside Europe, and to emphasize today's global economy.

The use of mathematics

For those students with a limited mathematical background an appendix to chapter 1 explains the basic quantitative relationships used in the main text. For those with a greater knowledge of mathematics, there are mathematical boxes explaining many of the key economic concepts. These mathematical boxes can be skipped if not required. In this way all economics students can use the text with confidence.

Optional chapters

We have tried to keep uppermost in our minds that time is always tight in an introductory course. For this reason, we have made sure that certain chapters can be skipped without losing the flow of the material. In microeconomics, chapter 11 (on the capital market) can be skipped because chapter 10 (on input markets in general) covers the basics of the capital market. Similarly, the *'topics'* chapters in Part Four can be skipped if time is short.

The teaching/learning package

Study Guide

A comprehensive Study Guide has been prepared by Ken Randall of Staffordshire University. Each chapter in the Study Guide corresponds to a chapter in the textbook and contains the following features:

The Chapter in Perspective which introduces the chapter topic, says why it is important, and how it relates to the rest of the material in the textbook.
Reviewing the Chapter which invites students to go through the textbook chapter, reviewing their knowledge of the Key Concepts in it and the crucial tables and diagrams.
Self-Test which lets students check whether they have understood the main ideas.
Structured Notes section which should be completed if the student is still unsure of their grasp of the chapter content. Completing the definitions and answering the questions in this section will create a set of structured notes on the chapter.
Collaborative Learning which suggests ways of working with fellow-students by testing each other's understanding of the topics in the Review section, giving short presentations on key concepts and debating controversial issues.
Answers are provided for the **Self-Test** and the **Structured Notes** sections. These vary from simple answers to explanatory paragraphs, as appropriate

The Study Guide complements the textbook by providing straightforward and flexible help to students who may be finding the chapter content difficult at first reading. On **taught** courses we expect students to use the Study Guide when they are having problems understanding the course, and are unable to get personal help from a tutor. On **open and distance learning courses** we expect the Study Guide to help students to structure their learning around the textbook, and help them to act as their own tutor.

Instructor's Manual

Rebecca Taylor, of the University of Portsmouth, has developed an innovative Instructor's Manual to accompany the text, adapted from the two Instructor's Resource Manuals for *Principles of Microeconomics* and *Principles of Macroeconomics* written by Patricia Euzent of the University of Central Florida.

The manual is designed to equip the instructor with the tools to deliver the text material effectively and to provide students with a valuable learning experience. The manual includes:

- Detailed chapter outlines with key terminology, teaching notes and lecture suggestions.
- Specific discussion suggestions to encourage students to relate the concepts being taught to personal and international issues.
- Global examples which make the learned material more relevant to the students.
- Extended Applications, which include exercises, activities and experiments to further student understanding of the topics being studied.
- Solutions to all odd-numbered problems from the text.

CD-ROM

The Instructor's Manual is supported by a CD-ROM containing PowerPoint slides of the key figures from the text, a test item file and the Prentice Hall Custom Test.

The Case, Fair, Gärtner, Heather test item file is a comprehensive test bank of approximately 1500 short-answer, multiple-choice, true/false, and problem set questions. The questions are divided into three levels of difficulty – easy, moderate and difficult. Problem sets (a series of questions based on a graph or scenario) can contain all three levels.

The test item file is designed for use with the Prentice Hall Custom Test, a computer package that allows users to custom design, save and generate classroom tests. The test programme (which runs on DOS and Windows-based computers) permits instructors to edit and add or delete questions from the test item file, to edit existing graphics and create new graphics, and to export files to various word processing programmes, including WordPerfect and Microsoft Word. Graphics capability ensures that all graphs included in the test item file can be printed next to the appropriate questions.

Additional information about the various forms of testing services can be obtained from your Prentice Hall sales representative.

A website to accompany the text is under development. Further details can be found at http://www.prenhall.co.uk

Teaching and learning features

We have attempted to make this text as clear and accessible as possible, catering for those students who have never studied economics before, as well as those with some previous knowledge. The language is lively and engaging and the content is highly topical and up to date. Wherever possible we have chosen examples which relate to students' own experience. The overall structure of the chapters is consistent throughout and the learning features are clearly identified. To familiarise yourself with these features and how they will benefit your study from this text, they are reproduced and described in the 'Guided Tour' following.

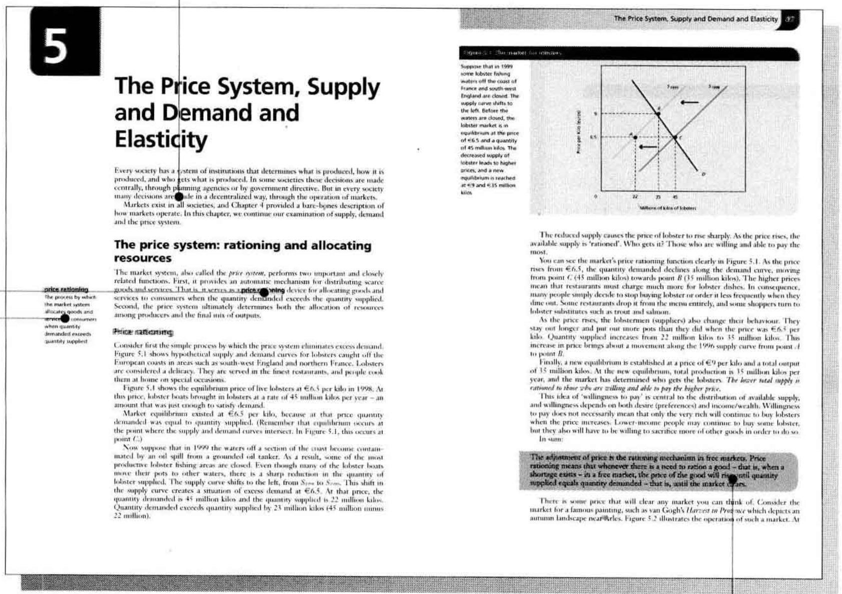
Guided Tour

Chapter beginning

Each chapter opens with a brief recap of what the student has learned in the previous chapter.

Key terms

Colour-highlighted within the text in yellow. Definitions are given in the margin.


5

The Price System, Supply and Demand and Elasticity

The price system: rationing and allocating resources

Major principles of economics

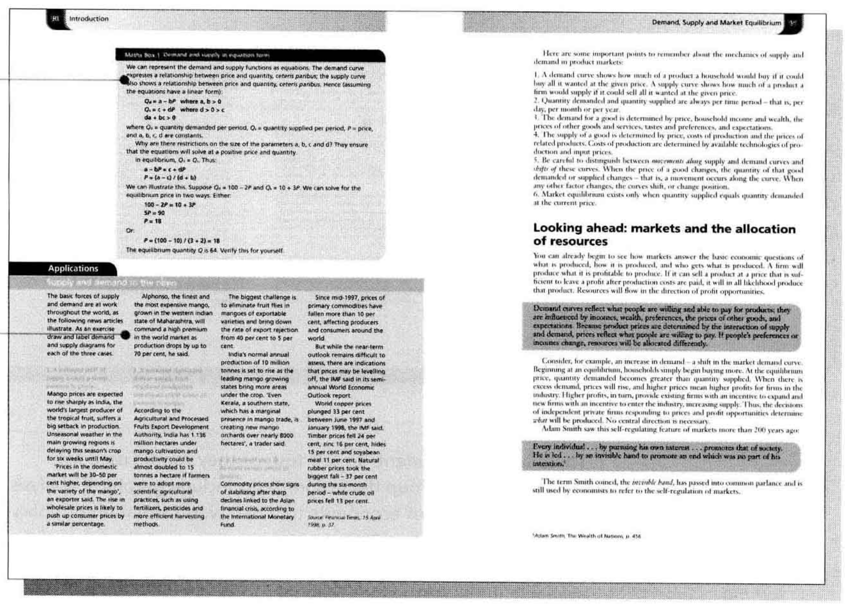
These are distinguished from the main text to highlight their importance and to aid revision and review.

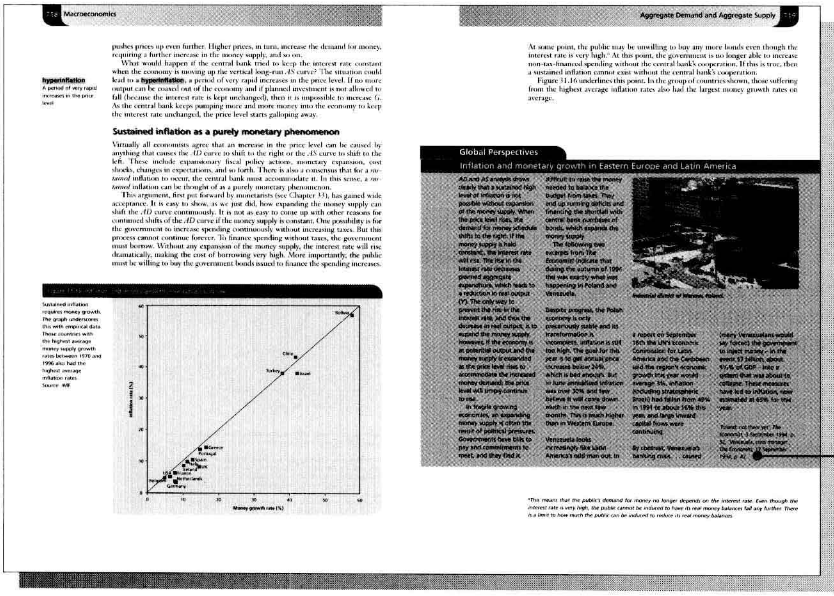
Maths boxes

The maths boxes illustrate the main economic concepts, supplementing the explanations in the text.

Application boxes

These bring economic theory to life with topical examples drawn from all over Europe.


Looking ahead: markets and the allocation of resources

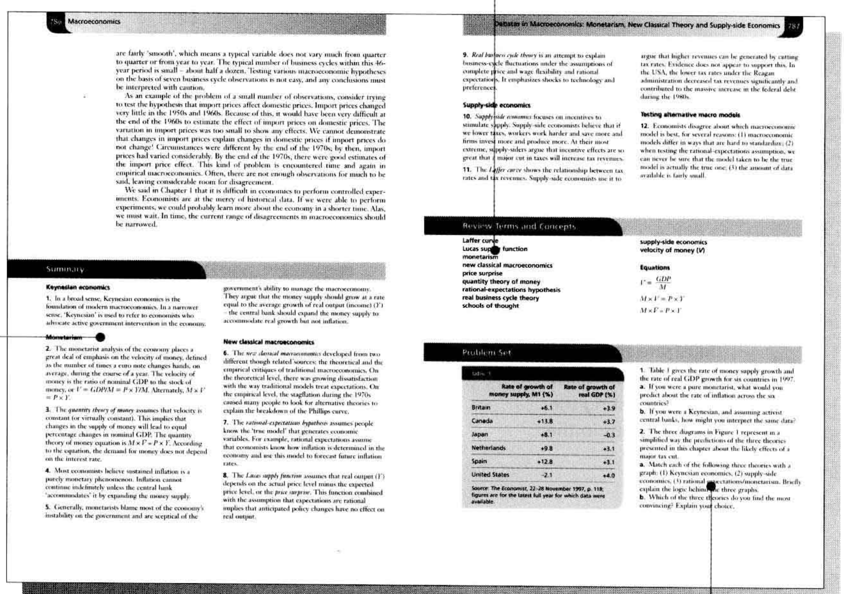


Global Perspective boxes

These illustrative boxes provide economic examples from around the world.

Review terms and concepts

An alphabetical collation of all the key terms in the chapter provides an aid to understanding and a convenient basis for revision.



Summary

A point-by-point summary of the chapter enables the student to review what they have covered.

Problem sets

These allow the students to self test, or they can be used as preparations for group discussion. Tasks include graphical analysis or the application of economics to a real world situation or policy decision. Solutions to selected questions appear at the back of the book. Remaining solutions, as well as additional problem sets, are available in the Instructor's Manual.

The Authors

European authors

Manfred Gärtner is Professor of Economics at the University of St Gallen. He is on the editorial board of the *European Journal of Political Economy* and his research has focused on open economy macroeconomics, trade unions and political economy. He has written journal articles and several other books, including *Macroeconomics under Flexible Exchange Rates* (Harvester Wheatsheaf, 1993) and *A Primer in European Macroeconomics* (Prentice Hall, 1997). He has taught macroeconomics at all levels as well as on courses on economic principles and international monetary economics.

Ken Heather is a senior lecturer in economics at the University of Portsmouth. He has taught on a wide range of courses in both macroeconomics and microeconomics. His research interests are primarily in industrial economics. He is the author of *Understanding Economics* (Prentice Hall, 1994, 1997) as well as numerous articles in the area of business economics.

US authors

Karl E. Case is the Marion Butler McLean Professor in the History of Ideas and Professor of Economics at Wellesley College. He also lectures on economics and tax policy in the International Tax Program at Harvard Law School. His research is in the areas of public finance, taxation and housing. He is the author or co-author of four other books, including *Economics and Tax Policy*, as well as numerous articles in professional journals.

Ray C. Fair is Professor of Economics at Yale University and a Fellow of the Econometric Society. Professor Fair's main research is in macroeconomics and econometrics, with particular emphasis on macroeconometric model building. His publications include *Specification, Estimation and Analysis of Macroeconometric Models* (Harvard Press, 1984) and *Testing Macroeconometric Models* (Harvard Press, 1994).

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Others have contributed to the support materials. A special word of thanks is due to Rebecca Taylor for her fine work on the Instructor's Manual and to Ken Randall for producing such an excellent student workbook.

We welcome comments about the book. Please write to us care of Economics Editor, Prentice Hall, Campus 400, Maylands Avenue, Hemel Hempstead HP2 7EZ, UK.

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The Use of Currencies

Our focus is distinctively European. As a result reference is made throughout the book to many different European countries and their currencies. Some illustrations use the euro, which is planned to be the currency unit in most European countries in the future. The table gives the relative values of all these currencies. Also included in the table are the US dollar and the Japanese yen. Since currency rates change over time these should only be regarded as approximate.

Cross rates enable us to see the value of any currency quoted in the table against any other such currency. If you are not familiar with such tables it is very simple to use. Start with a country and currency of your choice from the first column. Then read across to the column of the country whose relative currency value you wish to know. Take, for example the German mark (DM). Reading across to the column headed FFr enables us to see that one DM is worth about 3.352 French francs. In the UK the currency is the pound sterling. From the table it can be seen that one £ sterling exchanges for about 237 Spanish pesetas. The Dutch florin buys 4.266 Swedish kronor.

The euro is set to become increasingly significant throughout Europe. It can be seen from the table to be worth about 1.597 Swiss francs. It also buys about 1.203 US dollars.

The table can be useful to you as you read the book. Whenever an example or illustration is given in a particular currency, you can discover its approximate worth in any other currency you choose.

Currency cross rates

Country/Currency		BFr	DKr	FFr	DM	I£	L	Fl	NKr	E$	Pta	SKr	SFr	£	US£	Y	€
Belgium	(BFr)	100	18.42	16.24	4.846	1.944	4796	5.465	22.28	497.2	412.1	23.31	3.929	1.739	2.959	354.1	2.480
Denmark	(DKr)	54.28	10	5.815	2.630	1.055	2604	2.967	12.10	269.9	223.7	12.66	2.133	0.944	1.606	192.2	1.335
France	(FFr)	61.56	11.34	10	2.983	1.197	2953	3.364	13.72	306.1	253.7	14.35	2.419	1.071	1.822	216.0	1.514
Germany	(DM)	20.64	3.802	3.352	1	0.401	989.8	1.128	4.599	102.6	85.04	4.811	0.811	0.359	0.611	73.07	0.508
Ireland	(IE)	51.43	9.474	8.355	2.492	1	2467	2.811	11.46	255.7	211.9	11.98	2.021	0.694	1.522	182.1	1.265
Italy	(L)	2.085	0.384	0.339	0.101	0.041	100	0.114	0.465	10.37	6.592	0.486	0.082	0.036	0.062	7.382	0.051
Netherlands	(Fl)	16.30	3.371	2.972	0.587	0.356	877.6	1	4.077	90.98	75.40	4.266	0.719	0.318	0.542	64.79	0.450
Norway	(NKr)	44.88	8.267	7.290	2.175	0.873	2152	2.453	10	223.1	164.9	10.48	1.763	0.780	1.328	158.9	1.104
Portugal	(E$)	20.11	3.705	3.267	0.975	0.391	964.6	1.099	4.482	100	82.88	4.689	0.790	0.350	0.595	71.21	0.495
Spain	(Pta)	24.27	4.470	3.942	1.176	0.472	1184	1.326	5.407	120.7	100	5.657	0.953	0.422	0.718	85.92	0.597
Sweden	(SKr)	42.89	7.902	5.965	2.078	0.834	2057	2.344	9.558	213.3	178.8	10	1.685	0.746	1.269	151.9	1.055
Switzerland	(SFr)	25.45	4.469	4.134	1.233	0.495	1221	1.391	5.871	126.5	104.9	5.934	1	0.443	0.753	90.12	0.626
UK	(£)	57.50	10.59	9.341	2.786	1.118	2758	3.143	12.81	285.9	237.0	13.41	2.259	1	1.702	203.6	1.414
USA	($)	33.79	6.225	5.489	1.637	0.657	1621	1.847	7.530	168.0	139.3	7.878	1.328	0.588	1	119.7	0.831
Japan	(Y)	28.24	5.203	4.588	1.369	0.549	1355	1.543	6.293	140.4	116.4	5.584	1.110	0.491	0.638	100	0.595
Euro	(€)	40.68	7.490	6.605	1.970	0.791	1950	2.222	9.060	202.2	167.5	9.479	1.597	0.707	1.203	144.0	1

Note: The Danish and Norwegian krone, the Swedish krona and the French franc are per 10. The Belgian franc, Italian lira, Portuguese escudo, Spanish peseta and Japanese yen are per 100.

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