

E C O N O M I C S

Richard G. Lipsey

Peter O. Steiner

Douglas D. Purvis

Eighth Edition



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ECONOMICS

Richard G. Lipsey
Queen's University

Peter O. Steiner
The University of Michigan

Douglas D. Purvis
Queen's University

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Economics, Eighth Edition

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Preface

Economics is a living discipline. Through eight editions of *Economics*, our basic motivation has been to provide a text that reflects the tremendous changes in that discipline over the decades.

The first major theme of this book is to reflect the gradual movement of economics today toward becoming a science, exhibiting the key characteristic that marks any science: the systematic confrontation of theory with observation. Today most economists agree that their subject is more than a stage for parading pet theories. Nor is economics just a container for collecting masses of unrelated institutional and statistical material. Economists are expanding the frontiers of knowledge about the economic environment and learning to understand and often to control it. But new problems and new events are always challenging existing knowledge. Economists are therefore continually concerned with how theory, institutions, and facts relate to each other. Every theory is subject to empirical challenge.

A second major theme of this book concerns the relations between economic theory and economic policy. Decades of systematic observations have provided an ever-growing understanding of how things relate to one another quantitatively. This knowledge has increased economists' ability to make sensible and relevant statements about public policy. True, there remain many areas where economists' knowledge is painfully sparse, as current debates about supply-side economics and the nature of an appropriate monetary policy remind us.

The third major feature of the book has to do with the way we view students. We have tried to be as honest with them as possible within the limits of an introductory textbook. No subject worth studying is always easy, and we do not approve of slipping particularly hard bits of analysis past students without letting them see what is happening and what has been assumed, nor do we approve of teaching them things they will have to unlearn if they go on in economics (a practice sometimes justified on the

grounds that it is important to get to the big issues quickly). In short, we have tried to follow Albert Einstein's advice: make things as simple as possible, but not simpler.

Effective criticism of existing ideas is the springboard to progress in science. We believe that introductory economics should introduce students to methods for testing, criticizing, and evaluating the present state of the subject. We do not believe that it is wrong to suggest to students the possibility of criticizing current economic theory. Students will always criticize and evaluate their course content, and their criticisms are more likely to be informed and relevant if they are given practice and instruction in how to challenge what they have been taught in an effective, constructive manner.

Major Revisions in This Edition

Our main theme in this revision has been teachability. Every sentence, the structure of every argument, and every figure has been reviewed. Minor inconsistencies, and passages that our own and other teachers' experiences have told us are unnecessarily difficult, qualifications that belong only in more advanced treatments, unnecessary variations in the labelling of graphs, and a host of other smaller but significant problems have all received our attention. We hope that the result is a smoother and more teachable treatment throughout.

Some dramatic content changes have been made. The most important are listed below.

Changes in Microeconomics

1. We have shortened substantially the micro half of the book by reducing the number of examples, second-order qualifications, and other "fringe mate-

rial.” We believe that the new treatment has tightened the presentation while omitting nothing essential.

2. We have introduced Chapter 15 on oligopoly with an illustrative discussion of the rise and fall of OPEC. The rest of the chapter has been reworked to reflect many of the changes in economists’ views about oligopoly that are being developed in the literature on the “new industrial organization theory.”

3. Our surveys show that many instructors, hard pressed for time, omit the entire distribution section. We feel that this is a shame, since some of the ideas found in this section, such as the distinction between economic rents and transfer earnings, are fundamental to all of economics. To remedy this situation, we have written a wholly new introductory chapter to Part Five that contains the minimum that we think every student should know. We believe all students should read Chapter 18, even if they skip the more detailed material that follows.

4. Major microeconomic policy changes of three additional years of the Reagan administration are given extended treatment. These include a continuing trend to deregulation, a major retreat from antitrust enforcement, modifications in poverty and social service programs, and a thorough and sweeping reform of the tax structure that may well be the most important long-run achievement of the Reagan years.

Changes in Macroeconomics

1. The detailed treatment of index numbers has been combined with national income accounting into Chapter 25, “Measuring Macroeconomic Variables,” to present these topics more simply and more comprehensively than in previous editions.

The second half of Chapter 25, which deals with the meaning of the basic income concepts as defined by national income accountants, has been thoroughly reworked so as to reduce the discussion to its important and easily understood essentials.

2. Chapter 28 on aggregate supply has been thoroughly revised and, where possible, simplified. The chapter treats in detail the factors influencing the slope of the *SRAS* curve and the forces that cause the *SRAS* curve to shift. The distinction, important for most of the remaining chapters, between the

short-run aggregate supply curves (*SRAS*) and the long-run aggregate supply curves (*LRAS*) is met and carefully explained.

We feel that it is worth making the effort required to establish this distinction because, as economists, we are concerned about the many textbooks that carry out the bulk of their analysis with a single, stable *AS* curve. This simplifies teaching, but it risks serious confusion. The alert student, faced with a fixed *AS* curve and an *AD* curve that can be shifted by policy, will wonder why anyone would hesitate to pay the price of a once-and-for-all increase in the price level in order to obtain a permanent increase in output and employment. And who would hesitate, faced with such a trade-off?! To avoid such serious confusions, we introduce the shifting, short-run *AS* curve and the vertical, long-run *AS* curve at the outset.

3. The structure of Chapter 30, “Fiscal Policy,” is mostly unchanged from the seventh edition but the material has been extensively rewritten to increase its relevance and its teachability. The *AD* and *AS* apparatus are now fully integrated into the chapter. The historical discussion of fiscal policy in action has been considerably shortened in order to make room for an extended discussion of the implications of persistent government budget deficits.

4. The chapter on inflation has been reworked and greatly simplified. The emphasis is now more on long-term inflation control and less on the issue—important at the time of writing the previous edition—of how to break an entrenched inflation.

5. The international section has been revised and expanded to reflect the growing importance of international economic issues in American policy formation. The treatments of dynamic comparative advantage, nontariff barriers to trade, particularly voluntary export restrictions, and the longer-term consequences of the overvaluation of the American dollar—which is only being rectified at the time of writing—are all new or greatly expanded.

Teaching Aids

Tag lines and captions for figures and tables. The boldface tag line below or next to a figure or table

states briefly the central conclusion to be drawn from the illustration; the lightface caption gives information needed to reach that conclusion. Each title, tag line, and caption, along with the figure or table, forms a self-contained unit, useful for reviewing.

Boxes. The “boxes” contain examples or materials that are relevant extensions of the main text but need not be read as part of the text sequence. They are all optional. Some have further theoretical material. Others contain expansions and applications of points already covered in the text. The boxes give flexibility in expanding or contracting the coverage of specific chapters.

End-of-chapter material. Each chapter has a Summary, a list of Topics for Review, and Discussion Questions. The questions are designed for class discussion or for “quiz sections.” Answers appear in the Instructor’s Manual.

Appendixes. For several editions, the appendixes that give more detailed discussion of certain economics topics have been gathered in a separate section at the back of the text. In this present edition, for ease of use, we have placed the appendixes directly following the chapters to which they are related.

Mathematical notes. Mathematical notes are collected in a separate section at the end of the book. Since mathematical notation and derivation is not necessary to understand the principles of economics, but is helpful in more advanced work, this segregation seems to be a sensible arrangement. Mathematical notes provide clues to the uses of mathematics for the increasing number of students who have some background in math, without loading the text with notes that are useless and offputting to other readers. Students with a mathematical background have often told us they find the notes helpful.

Glossary. The glossary covers widely used definitions of economic terms. Because some users treat micro- and macroeconomics in that order, and others in the reverse order, words in the glossary are printed in boldface type when they are first mentioned in either half of the text.

Endpapers. Inside the front cover on the left is a list of the most commonly used abbreviations in the text; on the right appears a figure representing the relative importance of the national debt. Inside the back cover on the left is an illustration representing the major forms of federal expenditure. At the right is a table of selected time series, useful data on the United States economy since 1929.

Supplements

Our book is accompanied by a workbook, *Study Guide and Problems*, by Professors Dascomb R. Forbush and Fredric C. Menz. The workbook can be used either in the classroom or by the students on their own.

An *Instructor’s Manual*, prepared by us, and a *Test Bank* of 2,400 multiple-choice questions prepared under our supervision, are available to instructors adopting the book. The Test Bank is also available in a microcomputerized version called Harper Test, developed for Harper & Row by Economic Research, Inc.

New to this edition are fifty key theory diagrams reproduced from the text in the form of 2-color acetate transparencies; free to adopters. There are also over 100 transparency masters of important text figures available for classroom use.

Also new is the Lipsey Disk: Key Concepts for Review. This computerized student review tool asks fifteen crucial multiple-choice questions for each chapter. If an incorrect answer is given, the student is referred to specific text pages for further study; free to adopters. Available for an IBM PC.

Using the Book

Needs of students differ: some want material that goes beyond the average class level, but others have gaps in their backgrounds. To accommodate the former, we have included more material than we would assign to every student. Also, because there are many different kinds of first-year economics courses in colleges and universities, we have included more ma-

terial than normally would be included in any single course.

Although teachers can best design their own courses, it may help if we indicate certain views of our own as to how this book *might* be adapted to difference courses.

Sequence

The choice of macro first or micro first is partly a personal one that cannot be decided solely by objective criteria. We believe that in the 1980s there are good reasons for preferring the micro-macro order. The thrust over the last 20 years has been to examine the micro underpinnings of macro functions and to erect macroeconomics on a firmer base of micro behavioral relations. Virtually every current macro controversy turns on some micro underpinning. For “micro-firsters” this poses no problem. For “macro-firsters” it is often hard to explain what is at issue.

Changes occur not only in economic theory but in the problems that excite students. Many of today’s problems that students find most challenging—the plight of the cities, poverty, pollution—are microeconomic in character. The micro-macro order, moreover, reflects the historical evolution of the subject. A century of classical and neoclassical development of microeconomics preceded the Keynesian development of macroeconomics.

For those who prefer the macro-micro order, we have attempted to make reversibility easy. The overview chapter that ends Part One provides a base on which to build either the microeconomics of Part Two or the macroeconomics of Part Seven. Chapter 4 should be assigned after Chapter 3, even in macro-first courses. Where further microeconomic concepts are required—as in the macro investment chapter—we have added brief sections to make the treatment self-contained, while providing review material for those who have covered the microeconomic section.

One-Semester Courses

Many first courses in economics are only one semester (or equivalent) in length. Our book can be

easily adapted to such courses. Suggestions for using this book in such courses are given on page xxv.

Those Who Helped with This Edition

We are grateful to Robert Dernberger, Richard Porter, and Murray Smith for their detailed reviews of the chapters on China, development, and commercial policy, respectively.

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Richard G. Lipsey
Peter O. Steiner
Douglas D. Purvis

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So many teachers, colleagues, students, and friends contributed to the original book and to its continuing revision that it is impossible for us to acknowledge our debt to all of them individually. Hundreds of users, both teachers and students, have written us with specific suggested improvements, and much of the credit for the fact that the book has become more

teachable belongs to them. Those who reviewed the first through the fourth editions were listed in the fourth edition. But to convey a sense of the many more who have helped, we are listing here the names of all those who reviewed the fourth through the seventh editions:

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William C. Wood

To the Student

A good course in economics will give you insight into how an economy functions and into some currently debated policy issues. Like all rewarding subjects, economics will not be mastered without effort. A book on economics must be worked at. It cannot be read like a novel.

Each of you must develop an individual technique for studying, but the following suggestions may prove helpful. It is usually a good idea to read a chapter quickly in order to get the general run of the argument. At this first reading you may want to skip the “boxes” of text material and any footnotes. Then, after reading the Topics for Review and the Discussion Questions, reread the chapter more slowly, making sure that you understand each step of the argument. With respect to the figures and tables, be sure you understand how the conclusions stated in the brief tag lines with each table or figure have been reached. You should be prepared to spend time on difficult sections; occasionally, you may spend an hour on only a few pages. Paper and a pencil are indispensable equipment in your reading. It is best to follow a difficult argument by building your own diagram while the argument unfolds rather than by relying on the finished diagram as it appears in the book. It is often helpful to invent numerical examples to illustrate general propositions. The end-of-chapter questions require you to apply what you have studied. We advise you to outline answers to some of the questions. In short, you should seek to understand economics, not to memorize it.

After you have read each part in detail, reread it quickly from beginning to end. It is often difficult to understand why certain things are done when they are viewed as isolated points, but when you reread a whole part, much that did not seem relevant or entirely comprehensible will fall into place in the analysis.

We call your attention to the glossary at the end of the book. Any time you run into a concept that seems vaguely familiar but is not clear to you, check the glossary. The chances are that it will be there, and its definition will remind you of what you once understood. If you are still in doubt, check the index entry to find where the concept is discussed more fully. Incidentally, the glossary, along with the captions that accompany figures and tables and the end-of-chapter summaries, may prove very helpful when reviewing for examinations.

The bracketed colored numbers in the text itself refer to a series of 51 mathematical notes that are found starting on page 892. For those of you who like mathematics or prefer mathematical argument to verbal or geometric exposition, these may prove useful. Others may ignore them.

We hope that you will find the book rewarding and stimulating. Students who used earlier editions made some of the most helpful suggestions for revision, and we hope you will carry on the tradition. If you are moved to write to us, please do.

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