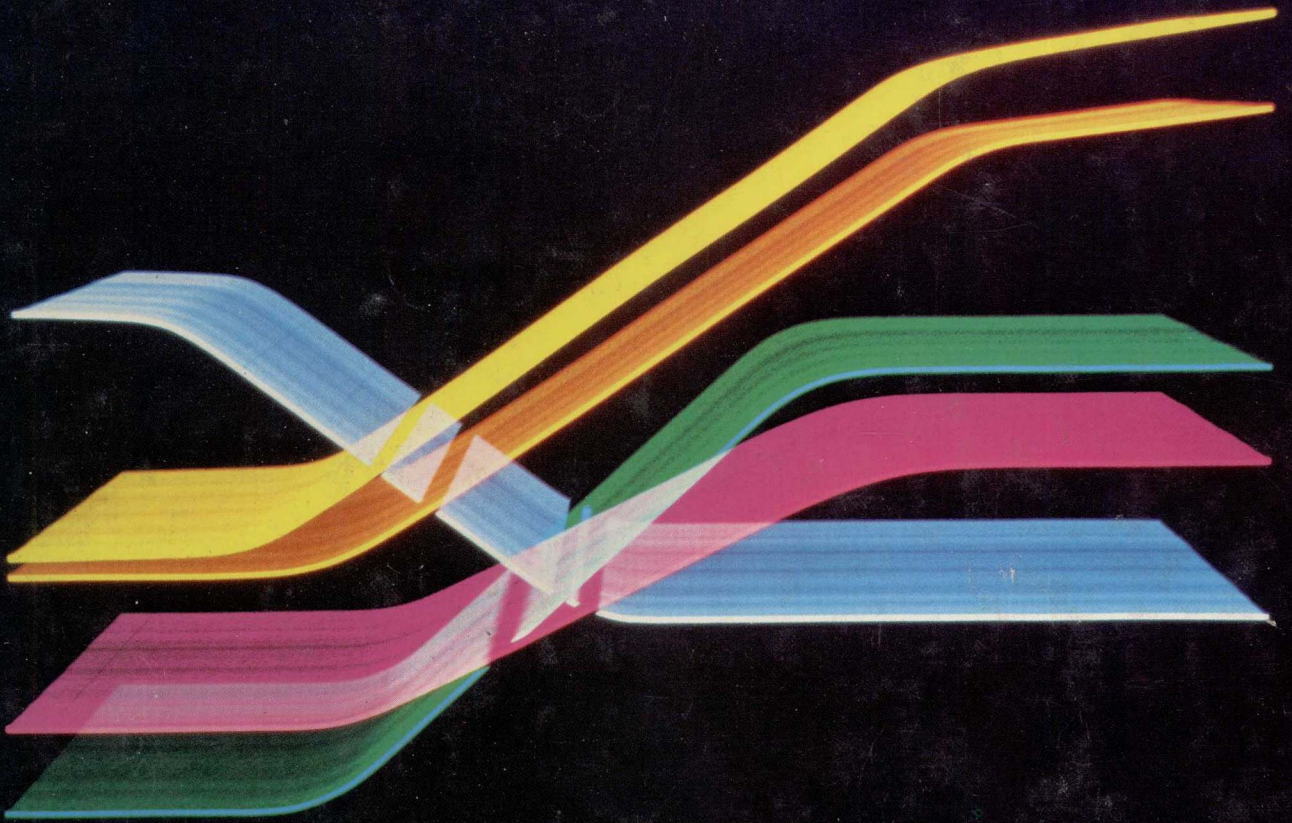


# Principles of Economics

Roy J. Ruffin   Paul R. Gregory



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# **Principles of Economics**

**Roy J. Ruffin**  
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# To the Instructor



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This book is a modern introduction to the principles of economics.

This book provides the most modern treatment of macroeconomics that is currently available. Keynesian (demand-side) economics is covered thoroughly as a prelude to the presentation of modern aggregate demand/aggregate supply analysis. The role of expectations is stressed throughout the presentation of macroeconomic theory. Although a full chapter is devoted to rational expectations, this chapter can be considered optional because the student is given the fundamentals of rational-expectations theory in the chapters on inflation and stabilization policy. Empirical data and abundant real-world examples reinforce the student's learning of macroeconomics.

The presentation of microeconomics is far more concrete in this book than in most textbooks. Real-world examples, rather than fanciful or hypothetical ones, illustrate concepts like comparative advantage, increasing returns, increasing-cost industries, or *U*-shaped cost curves. Microeconomic theory is brought even closer to the real world by including a chapter on information costs and by drawing upon the research of industrial-organization economists to enrich the price-theory discussions. The chapter on information or transactions costs (31) includes a discussion of futures markets, the economics of search, speculation, intermediaries or "middlemen," and problems of product quality. This book also introduces the modern microeconomic topics of adverse selection, moral hazard, signaling, and unions as a voice mechanism at an elementary level.

## Organization

This book is organized into six parts. Part I (Chapters 1–4) introduces the basic concepts of economics that must be learned before proceeding to the study of either macroeconomics or microeconomics. These four chapters contain the standard topics of economic methodology, how to read graphs, scarcity, opportunity costs, the production-possibilities frontier, the law of diminishing returns, the law of comparative advantage, the workings of the price system, and the laws of supply and demand. In addition, the student is introduced to the concepts of relative prices and marginal decision making, which are crucial topics in both microeconomics and macroeconomics. From Part I, the instructor can move either to macroeconomics (Chapters 5–22) or to microeconomics (Chapters 23–41).

The macroeconomics sequence begins in Part II with the basic macroeconomic concepts of inflation, unemployment, and the business cycle (Chapter 5), followed by national income accounting (Chapter 6). Monetary economics (Chapters 7 and 8) is placed between national income accounting and the chapters on Keynesian economics (Chapters 9–11). Although the monetary chapters could be taught following Chapter 10 (on the multiplier), the present organization allows the instructor to move directly into monetary policy and the modern model of aggregate demand and supply. We believe it is easier to recall national income accounting while touring money than to recall the Keynesian model while touring money. In addition, learning the deposit multiplier appears to make it easier for students to learn the somewhat more difficult concept of the expenditure multiplier.

The core of modern macroeconomics is found in Chapters 12–14. Chapter 12 introduces the basic tools and concepts of aggregate demand and supply and the natural-rate hypothesis. Chapters 13 and 14 give a thorough analysis of the causes of inflation and modern views of the Phillips curve. Chapters 15–17 round out the discussion of modern macroeconomics by focusing on the debates about stabilization policy (Chapter 15), the trends and causes of unemployment (Chapter 16), and rational-expectations theory (Chapter 17). Economic growth and development are discussed in Chapters 18 and 19. Part III is a three-chapter unit on international economics.

Part IV begins the microeconomics core with a ten-chapter unit on the product market (Chapters 23–32). Chapter 23 teaches price elasticities of demand and supply as well as income and cross-price elasticities of demand. Chapter 24 deals with demand and utility (with an appendix on indifference curves). Business organization and corporate finance are discussed in Chapter 25, and short-run and long-run costs are explained in Chapter 26 (with an appendix on equal-output curves, or isoquants). The standard market models—perfect competition, monopoly and monopolistic competition, and oligopoly—are covered in Chapters 27–30, with a special chapter (29) devoted to comparing monopoly and competition. Chapter 31 introduces the role of information costs, and Chapter 32 discusses government/business relations, particularly government regulation and antitrust law.

Factor markets are taught as a five-chapter unit in Part V (Chapters 33–37). Chapter 33 gives a theoretical overview of the workings of factor markets, and Chapters 34 and 36 focus on specific factor markets. Chapter 35 considers the role of labor unions, and Chapter 37 considers the determinants of income distribution and poverty.

Microeconomic issues are the focus of Part VI (Chapters 38–41). Chapter 38 examines the issues of public finance and taxation; Chapter 39 explains the economics of exhaustible resources and of market failure (public goods and externalities); Chapter 40 discusses modern theories of public choice; Chapter 41 explores comparative economic systems (with an appendix on the economics of Marx).

## Suggestions for Course Planning

This book is intended for the two-semester sequence in microeconomics and macroeconomics that is traditionally taught as a first- or second-year college course. The book is available in both a combined hardbound volume and micro/macro split softbound volumes. The combined volume can also be used for an intensive one-semester course that covers both microeconomics and macroeconomics by selecting only core chapters (as suggested below). Since the book was written with the micro/macro splits in mind, even the instructor who is using the combined volume can teach either macro or micro first.

### Suggested Outline for an Intensive One-Semester Course (30 chapters)

#### Introduction:

- 1 The Nature of Economics
- 2 The Economic Problem
- 3 The Price System
- 4 The Mechanics of Supply and Demand

#### Macroeconomics:

- 5 Macroeconomic Concepts
- 6 Measuring National Income and National Product
- 7 Money and Prices
- 8 Commercial Banking and the Federal Reserve
- 9 Keynesian Economics
- 10 Output Fluctuations: The Multiplier and the Accelerator
- 11 Keynesian Monetary and Fiscal Policy
- 12 Aggregate Demand and Aggregate Supply
- 13 Inflation
- 14 Inflation and Unemployment
- 15 Stabilization Policy

#### Microeconomics:

- 23 Elasticity of Supply and Demand
- 24 Demand and Utility
- 25 Business Organization
- 26 Costs and Productivity
- 27 Perfect Competition
- 28 Monopoly and Monopolistic Competition
- 30 Oligopoly
- 31 The Economics of Information
- 32 Antitrust Law and Regulation
- 33 Factor Markets
- 34 Labor Markets
- 37 Income Distribution and Poverty
- 38 Public Finance
- 39 Market Failure: Energy and the Environment
- 40 Public Choice

## Suggested Outline for an Intensive One-Quarter Course (23 chapters)

### Introduction:

- 1 The Nature of Economics
- 2 The Economic Problem
- 3 The Price System
- 4 The Mechanics of Supply and Demand

### Macroeconomics:

- 5 Macroeconomic Concepts
- 6 Measuring National Income and National Product
- 7 Money and Prices
- 8 Commercial Banking and the Federal Reserve
- 9 Keynesian Economics
- 10 Output Fluctuations: The Multiplier and the Accelerator
- 11 Keynesian Monetary and Fiscal Policy
- 12 Aggregate Demand and Aggregate Supply
- 14 Inflation and Unemployment
- 15 Stabilization Policy

### Microeconomics:

- 23 Elasticity of Supply and Demand
- 24 Demand and Utility
- 25 Business Organization
- 26 Costs and Productivity
- 27 Perfect Competition
- 28 Monopoly and Monopolistic Competition
- 33 Factor Markets
- 34 Labor Markets
- 37 Income Distribution and Poverty

Instructors who want a course with a focus on growth and development should incorporate Chapters 18 on Economic Growth and 19 on Problems of Population and Economic Development. Instructors who want a course with a focus on international economics should incorporate Chapters 20–22 on International Trade and Comparative Advantage, Protection and Free Trade, and the International Monetary System and Chapter 41 on Comparative Economic Systems.

Instructors who want a one-semester course that is more heavily micro can choose the core macro chapters in the Quarter Course list above and the micro chapters from the Semester Course list above. Those who desire a course with a heavier macroeconomic emphasis can choose the micro chapters from the Quarter Course list above and the macro chapters from the Semester Course list.

## Supplements

This book has a complete package of supplements, which includes an *Instructor's Manual*, *Study Guide*, *Test Bank*, and *Transparency Masters*.

The *Instructor's Manual* was written by the authors. Each of the 41 chapters contains sections on: points to learn in the chapter, chapter organization, special approaches, optional material, teaching hints and special projects, bad habits to unlearn, additional essay questions, answers to end-of-

chapter “Questions and Problems,” and answers to the “Review Quiz” for that chapter in the *Study Guide*.

The *Instructor's Manual* is a valuable teaching aid because it supplies the instructor with additional numerical examples not contained in the text and additional real-world illustrations not discussed in the text. A chapter outline gives a brief overview of the material in the chapter that assists the instructor in preparing lecture outlines and in seeing the logical development of the chapter. The special-approaches section tells the instructor how this chapter is different from other textbooks and explains why a topic was treated differently in this text or why an entirely new topic not covered by other texts was introduced in the chapter. The optional-material section gives the instructor a ranking of priorities for the topics in the chapter and enables the instructor to trim the size of each chapter (if necessary).

The *Study Guide* was written by John Vahaly of the University of Louisville. Because the *Study Guide* is quite analytical, it will challenge the student and help him or her to better prepare for exams. The *Study Guide* supplements the text by providing summaries of the crucial elements. It contains multiple-choice and true/false questions, but unlike other study guides, it contains not only the answers to the multiple-choice and true/false questions but also *explanations for the answers*. Instead of just giving lists of the correct *a*, *b*, *c* responses or a list of *Ts* and *Fs*, the *Study Guide's* answer sections explain *why* a particular objective answer is the correct one. In addition to objective questions, each chapter of the *Study Guide* also contains analytical problems and questions. Again, the *Study Guide* provides not only the answers to the questions, but the step-by-step process for arriving at the answer.

At the back of the *Study Guide* is a “Review Quiz” for each chapter that contains multiple-choice questions the answers for which do *not* appear in the *Study Guide* but do appear in the *Instructor's Manual*. These quizzes can be used by the instructor as homework or as chapter quizzes.

The authors have also prepared a *Test Bank* that contains nearly 1,800 multiple-choice questions—most of which have already been class tested. The answers have been checked and double checked to minimize the chances that any of the questions have more than one answer. For each chapter in the text, the *Test Bank* contains 4 different tests (coded A, B, C, or D). Whether the instructor is trying to compose a one-chapter quiz or a 23-chapter final exam, that instructor can choose from among the questions in the *Test Bank*, the questions in the “Review Quizzes” at the back of the *Study Guide*, or the additional essay questions in the *Instructor's Manual*—more than 2,300 questions in all. The *Test Bank* is available both on perforated paper in book form and on computer tape.

*Transparency Masters* suitable for overhead projectors are available for all key figures and tables (about 150 items).



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# To the Student



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Many students find economics a difficult subject because, unlike many other courses a college student takes, economics cannot be mastered through memorization. Economics relies on economic theories to explain real-world occurrences—like why people tend to buy less when prices rise or why increased government spending may reduce unemployment. An economic theory is simply a logical explanation of why the facts fit together in a particular way. If the theory were not logical, or if the theory failed to be confirmed by real-world facts, it would be readily discarded by economists.

The successful student will be the one who learns that economics is built upon a number of fairly simple and easy-to-understand propositions. These propositions and assumptions—that businesses seek to maximize profits or that consumers base their expenditure decisions on disposable income, for example—form the building blocks upon which economics is based. These propositions are typically little more than common sense and should not intimidate a student. If a major building block is missing, however, the whole structure can fall apart. To prevent the student from overlooking or forgetting a crucial building block, we frequently engage in pedagogical review. In other words, when a new proposition is added to a theoretical structure, the underlying propositions are reviewed.

Another factor that can make economics difficult for a student is that economics—like other academic disciplines—has its own specific vocabulary. Unlike the physical sciences, however, where the student may be encountering a certain term for the first time, much of the vocabulary of economics—terms like *efficiency*, *capital*, *stock*, *unemployment*—has a common usage that is already familiar to the student. Economists, however, use the vocabulary of economics in a very exact way, and often the common usage of a term is not the same as the economic usage. In this book, each key

term appears in boldface type where it is first discussed in text. Immediately following the paragraph where the term first appears in boldface type, the formal, economic definition of the term is set off in color. At the end of each chapter is a list of all the key terms that have been boldfaced and given formal definitions in that chapter; a glossary at the end of the book contains all the definitions of key terms and gives the chapter number in which the term was defined.

The modern developments in economics are simply new attempts to explain in a logical manner how the facts bind together. Modern developments have occurred because of the realization that established theories were not doing a good job of explaining the world around us. Fortunately, the major building blocks of modern theory—that people attempt to anticipate the future, that rising prices motivate wealth holders to spend less, that people and businesses gather information and make decisions in a rational manner—rely on common-sense logic.

Economics is only valuable if it explains the real world. Economics should be able to answer very specific questions like: Why are there three major domestic producers of automobiles and hundreds or even thousands of producers of textiles? Why is there a positive association between the growth of the money supply and inflation? Why does the United States export computers and farm products to the rest of the world? Why do restaurants rope off space during less busy hours? If Iowa corn land is the best land for growing corn, why is corn also grown in Texas while some land stands idle in Iowa? Why do interest rates rise when people expect the inflation rate to increase? Why did the price of petroleum rise so rapidly in the 1970s? The successful student will be able to apply the knowledge he or she gains of real-world economic behavior to explain any number of events that have already occurred or are yet to occur.

In writing this book, we have made a conscious effort to present arguments and evidence on both sides of every economic controversy. We attempt to make a case for each distinct viewpoint, even if it would be more interesting and less complicated to come out strongly in one camp. Although we are aware of our own free-market bias, we believe it is best to allow the student to keep an open mind at this very early stage in the study of economics.

This book contains a number of important learning aids.

1. The *Chapter Preview* that precedes each chapter provides a brief overview of the important points to be learned in that chapter.
2. *Definitions of Key Terms* are set off in color following the paragraphs in which the terms are introduced in context.
3. *Key Ideas*, important economic principles or conclusions, are set off in color in bold, italicized type.
4. *Boxed Examples* allow the student to appreciate how economic concepts apply in real-world settings without disrupting the flow of the text and supplement the numerous examples already found in the text discussions.
5. A *Chapter Summary* of the main points of each chapter is found at the end of each chapter.
6. *Key Terms* that were defined in color in the chapter are listed at the end of each chapter.
7. *Questions and Problems* that test the reader's understanding of the chapter follow each chapter.
8. A *Glossary*, containing all key terms defined in color in chapters and listed in chapter "Key Terms" sections, appears at the end of the book. Each entry contains the complete economic definition as well as the number of the chapter where the term was first defined.
9. The *Index* of all the names, concepts, terms, and topics covered in the book is one of the most thorough indexes ever compiled for an introductory economics text.
10. Statistical data on the major economic variables are found on the front and back inside covers for easy reference.
11. *Suggested Readings* are listed for each chapter at the back of the book.

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Roy J. Ruffin  
Paul R. Gregory

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