

MICROECONOMICS

A Contemporary Introduction



WILLIAM A. McEACHERN

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*William A. McEachern
Professor of Economics
University of Connecticut*



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P R E F A C E

Economics is over two hundred years old, but it is new every day. Each day offers a fresh batch of evidence that can be used to support or to reshape evolving economic theory. Principles texts written initially in the 1950s, 1960s, and 1970s may not be relevant in the 1990s. As Schumpeter pointed out, competition is a process of creative destruction. Evidence suggests that instructors are often looking for something new, something better. In this book, I try to convey the vitality and excitement of the discipline and to show students that economics has relevance to the “ordinary business of life.” I am new enough to the task to keep it fresh, but experienced enough to get it right.

I rely on common experience to convey economic principles. Remember the last time you were in a strange neighborhood and had to ask for directions? Along with the directions you may have heard the standard comment, “You can’t miss it.” So how come you missed it? Writing a principles text is much like giving directions. The author’s familiarity with the material can be both a strength and a weakness. It is a strength, of course, in that the author really understands the material. But it can also be a weakness if the author provides so much detail that central features get lost. The secret is to provide just enough detail. Good directions make use of landmarks familiar to all—a gas station, a stoplight, a fork in the road. Likewise, in this book I draw on experiences common to all of us—reading a report on increased inflation; choosing between a ball game and a movie; deciding whether to pack a lunch or buy a Big Mac.

Economics is too important to neglect because it seems too difficult or, worse yet, irrelevant. I try to avoid the sort of hand waving so often used in other texts to “explain” difficult topics. To present economic principles, I use what I call the “double IDEA” approach: Intuition and Insight, Displays and Diagrams, Explanations and Examples, Analysis and Application. Drawing on common experience, I begin with intuition and insight. Once students have an initial grasp of a principle, displays and diagrams are introduced to

shed light on that principle. (In contrast, some books use diagrams the way a drunk uses a lamppost—more for support than for illumination.) My diagrams and displays are accompanied by explanations and examples. Finally, the principle is subjected to analysis and application. Thus, the presentation begins naturally with the student's own experience and ends with the application of an economic principle.

This clarity of presentation provides an instructor with greater flexibility in the classroom and promotes more effective use of scarce class time. The instructor can explore in greater detail a topic of special interest but need not feel hemmed in by a requirement to cover everything in the book. The book provides much running room. Moreover, the examples in the text are all fresh. The instructor can use more traditional examples in class, and they will also seem new to students.

- a review of recent developments in the labor movement
- a current, comprehensive analysis of poverty, income distribution, and welfare reform
- an explanation of wage differentials, an analysis of comparable worth, and a review of theories of profit and entrepreneurship
- a presentation of alternative theories of regulation, plus a discussion of deregulation and re-regulation
- coverage of newer topics such as contestable markets, vertical integration, the market for corporate control, rent seeking, and public choice

The treatment of microeconomics in this text underscores the role of time and information in production and consumption. It also reflects the increasing interest in economic institutions, particularly the internal organization of households, firms, and governments. For example, the recent changes that have occurred in the division of labor within the household are highlighted throughout the text. In fact, three chapters are devoted to the internal workings of economic institutions.

More generally, I try to convey the idea that most microeconomic principles operate like gravity: they work whether or not we understand them. For example, consumers need know nothing about utility theory in order to behave as if they maximize utility. They need only behave in accordance with rational self-interest.

Organization

I have written a book that flows. Chapters in many principles texts are interrupted by boxed case studies, parenthetical explanations, contrived subdivisions, qualifying footnotes, and other distractions that mar the natural flow of the story. For example, case studies in other texts are usually

segregated from the chapter's mainstream, leaving students uncertain about if and when they should be read.

Each chapter in this book is divided into logical sections and subsections. Rather than simply breaking the chapter into digestible units, the organization enhances the presentation. Qualifying footnotes are used sparingly, and parenthetical explanations are used hardly at all. Moreover, case studies appear in the natural flow of the exposition. The student can thus read each chapter from beginning to end. Each chapter, rather than being chopped into a series of definitions and qualifications, tells a compelling story.

Each chapter opens with a paragraph that both motivates the chapter and describes the major sections. Chapters consist of two or three major sections, with each section typically summarized as the chapter progresses. An end-of-chapter summary gathers together the major points of the chapter.

Major features of each chapter include the following:

Captioned Exhibits. A brief summary appears along with each diagram. These captions point out the lessons to be drawn from the analysis.

Marginal Definitions. Important economic terms are fully discussed in the body of the text but are also defined in the margins.

Case Studies. As mentioned before, case studies are not set off in boxes, as in other texts, but are integrated into the body of the chapter. The student therefore has no doubt that the case studies are to be read. These could serve as a basis for class discussion.

Profiles of Famous Economists. Rather than focus primarily on biographical information, the profiles discuss famous economists' contributions to economic thought. This material complements the analysis presented in the body of the text and is positioned to follow the flow of ideas in the chapter.

End-of-Chapter Material. Each chapter closes with a summary plus questions and problems that can be discussed either in class or during weekly discussion sections. Suggested answers are provided in the *Instructor's Manual*.

Appendixes. Several end-of-chapter appendixes provide more detailed treatment of various topics. Appendix material is typically more advanced than that contained in the body of the chapter. The only exception is the appendix to Chapter 1, which is recommended for all students unfamiliar with variables, graphs, slopes, and the like. Aside from the graphical appendix, however, subsequent material does not build on the appendixes, so their use is purely optional. Including more difficult material in this way offers the instructor greater flexibility of coverage with no loss of continuity.

Glossary. Key terms are listed alphabetically in a glossary, which appears just before the index.

Supplementary Items for Students

Study Guide. The student *Study Guide* has chapters that correspond to each chapter in the text. Each chapter includes (1) a chapter outline, including definitions of all terms; (2) a discussion of the chapter's major points; (3) "Lagniappe," which offers extensions of material in the chapter, with each extension accompanied by a "Question to Think About"; (4) a variety of questions, including fill-in-the-blanks, true/false, multiple choice, and discussion questions; and (5) answers to all these questions.

MicroGraph. MicroGraph is a microcomputer tutorial that is available free of charge through your South-Western representative. MicroGraph's four modules illustrate key ideas in microeconomics. These tutorials can be copied and provided to students, or they can be placed in a microcomputer lab.

Supplementary Items for Instructors

Instructor's Manual. The *Instructor's Manual* contains a chapter corresponding to each chapter in the text. Each chapter includes (1) a brief overview of the text chapter; (2) an outline drawn from the headings in the text chapter; (3) an extensive summary of the chapter's major points; (4) pedagogical tips that expand on points raised in the chapter; and (5) suggested answers to the end-of-chapter questions and problems.

Teaching Assistant's Manual. Instructors with teaching assistants can provide each with a *Teaching Assistant's Manual* written especially for those who meet once a week with students in a discussion or quiz section. The manual contains a chapter corresponding to each chapter of the text and offers (1) a brief overview of the text chapter; (2) an outline drawn from the headings in the text chapter; (3) additional material for class discussion; (4) an indication of topics in the chapter warranting special attention; (5) additional examples to supplement those provided in the chapter; (6) "What if?" questions for class discussion; and (7) an extensive list of short-answer questions for the quizzes administered in these weekly sections. In addition to the chapter-by-chapter accounts, four appendixes at the end of the manual provide general advice on (a) presenting material; (b) generating and maintaining class discussions; (c) preparing, administering, and grading quizzes; and (d) coping with the special challenges confronted by foreign teaching assistants. Even those with previous teaching experience may find this manual helpful.

Two-Color Transparencies. A set of acetate transparencies reproduces important illustrations from the text.

Test Bank. The *Test Bank* available to adopters contains more than 3200 multiple choice questions, with five options for each question. None of the questions duplicates those provided in the *Study Guide*. Questions are rated according to three levels of difficulty. The *Test Bank* is available in both printed and microcomputer (MicroSWAT II) formats.

Acknowledgments

This book benefited greatly from careful review by economists from around the country. They share much of the credit but none of the blame for the final product. I would like to thank the following, who reviewed substantial portions of the manuscript: Polly Reynolds Allen, University of Connecticut; Jacqueline M. Browning, Texas A&M University; Art Goldsmith, University of North Carolina at Chapel Hill; Rich Hart, Miami University; Andrew J. Policano, University of Iowa; Steven M. Sheffrin, University of California, Davis; Roger Sherman, University of Virginia; Houston Stokes, University of Illinois at Chicago; Gregory H. Wassall, Northeastern University; and Leland B. Yeager, Auburn University.

Anybody familiar with an undertaking of the magnitude knows that much help is required. I relied on comparative advantage and the division of labor to prepare the most complete teaching package on the market today. Richard Langlois authored the biographies featured throughout the text. John Lunn wrote the *Study Guide*. Nancy Fox and Alannah Orrison prepared the *Test Bank*. And David Kleykamp was my coauthor for the *Instructor's Manual*. For their cooperation and contribution to the project, I am grateful.

Finally, I owe a special debt to my wife, Pat, who provided encouragement and good cheer during the years of writing. For her patience and inspiration, I dedicate this book to her.

CONTENTS

PART 1 Introduction to Economics

2

1 The Art and Science of Economic Analysis	4	<i>Quantities? • How Will Goods Be Produced? • For Whom Will Goods Be Produced? • The Interdependence of the Questions What, How, and For Whom?</i>	
The Economic Problem	5	<i>Alternative Ways of Answering the Three Economic Questions</i>	43
<i>Resources • Goods and Services • Economic Actors • Microeconomics and Macroeconomics</i>		<i>Pure Capitalism • Command Economy • Mixed Economies</i>	
The Art of Economic Analysis	7		
<i>Rational Self-Interest • Economic Analysis Is Marginal Analysis • Choice Requires Time and Information</i>			
The Science of Economic Analysis	9		
<i>The Role of Theory • The Scientific Process • Predictions Versus Forecasts • Normative Versus Positive Analysis • Economists Tell Stories</i>			
Some Pitfalls of Economic Thinking	13		
<i>Fallacy That Association Is Causation • Fallacy of Composition • Ignoring the Secondary Effects</i>			
If Economists Are So Smart, Why Aren't They Rich?	15		
Appendix: Understanding Graphs	18		
2 Some Tools of Economic Analysis	27	3 The Market System	47
Opportunity Cost and Choice	27	Demand	47
<i>Opportunity Cost in a Land of Plenty • Your Opportunity Cost • Opportunity Cost Is Subjective</i>		<i>What Is Demand? • The Demand Schedule and Demand Curve</i>	
The Economy's Production Possibilities	31	Shifts in the Demand Curve	52
<i>Efficiency and the Production Possibilities Frontier • The Shape of the Production Possibilities Frontier • Shifts in the Production Possibilities Frontier</i>		<i>Changes in Income • Changes in the Prices of Related Goods • Changes in Price Expectations • Changes in the Number of Consumers • Changes in Tastes</i>	
Specialization, Comparative Advantage, and Exchange	36	Supply	55
<i>The Law of Comparative Advantage • Absolute and Comparative Advantage • Specialization and Exchange • Division of Labor and Gains from Specialization</i>		<i>The Supply Schedule and Supply Curve</i>	
Three Economic Questions: What, How, and For Whom?	41	Shifts in the Supply Curve	57
<i>What Will Be Produced and in What</i>		<i>Changes in Technology • Changes in the Prices of Relevant Resources • Changes in the Prices of Alternative Goods • Changes in Producer Expectations • Changes in the Number of Producers</i>	
		Putting It All Together: Supply, Demand, and Equilibrium	60
		<i>Markets • Specialized Markets • Market Equilibrium</i>	
		Changes in Equilibrium Price and Quantity	63
		<i>Impact of Demand Shifts on Equilibrium Price and Quantity • Impact of Supply Shifts on Equilibrium Price and Quantity • Simultaneous Shifts in Supply and Demand</i>	
		Disequilibrium Prices	68
		<i>Government-Contrived Disequilibrium • Disequilibrium in Private Markets</i>	

4 The Economic Actors: Households, Firms, and Governments	75	Supporting Actor: The Firm	80
Introduction	75	Transaction Costs and the Firm •	
Starring: The Household	76	Why Does Household Production Still Exist? • Why Do Some Firms Specialize? • Kinds of Firms • Nonprofit Firms	
Households Maximize Utility • A House Is Not Necessarily a Home • Households as Resource Suppliers • Households as Demanders of Goods and Services • The Evolution of the Household		Supporting Actor: The Government	85
		The Role of Government • The Structure of Government • Size and Growth of Government • Sources of Revenue	

PART 2 Introduction to the Market System **98**

5 Elasticity of Demand and Supply	100	Measuring Utility	127
Price Elasticity of Demand	101	Units of Utility • Utility Maximization in a World Without Scarcity • Utility Maximization in a World of Scarcity • Deriving the Law of Demand from Marginal Utility	
Calculating Elasticity of Demand • Categories of Demand Elasticity • Elasticity and Total Revenue • Refining the Calculations: The Midpoint Formula • Price Elasticity and the Linear Demand Curve • Three Extremes of Elasticity		Consumer Surplus	135
Determinants of Demand Elasticity	110	Deriving the Market Demand from Individual Demand	137
Availability of Substitutes • Proportion of the Consumer's Budget Spent on the Good • Price Elasticity and the Definition of the Good • A Matter of Time • Luxuries Versus Necessities • Elasticity Estimates		The Role of Time in Demand	138
Price Elasticity of Supply	113	Appendix: Indifference Curves	142
Categories of Supply Elasticity • Determinants of Supply Elasticity		7 Cost and Production in the Firm	151
Elasticity and Tax Incidence: An Application	117	Cost and Profit	151
Demand Elasticity and Tax Incidence • Supply Elasticity and Taxes		Explicit and Implicit Costs • Alternative Measures of Profit	
Other Elasticity Measures	120	Production and Cost in the Short Run	154
Income Elasticity of Demand • Cross- Price Elasticity of Demand		Costs Under the Golden Arches • The Law of Diminishing Returns • The Total and Marginal Physical Product Curves	
6 Consumer Choice and Demand	125	Costs in the Short Run	158
Utility Analysis	125	Total Cost and Marginal Cost in the Short Run • Average Costs in the Short Run • Summary of Short-Run Cost Curves	
Tastes and Preferences • The Law of Diminishing Marginal Utility		Costs in the Long Run	165
		Long-Run Average Cost Curves • Economies of Scale • Diseconomies of Scale • Constant Returns to Scale	
		Appendix: A Closer Look at Production and Costs	174

PART 3 Market Structure, Pricing, and Government Regulation

184

8 Perfect Competition	186	<i>Shutdown Decision • Long-Run Profit Maximization • Myths About Monopolies</i>	
An Introduction to Perfect Competition	186	Monopoly and the Allocation of Resources	229
<i>Perfectly Competitive Market Structure • Demand Under Perfect Competition</i>		Price and Output Under Perfect Competition • Price and Output Under Monopoly • Allocative and Distributive Effects	
Short-Run Profit Maximization	189	Problems with Estimating the Welfare Cost of Monopoly	231
<i>Total Revenue Minus Total Cost • Marginal Cost Equals Marginal Revenue in Equilibrium • Measuring Profit in the Short Run</i>		Why the Welfare Loss of Monopoly Might Be Lower • Why the Welfare Loss of Monopoly Might Be Higher	
Minimizing Short-Run Losses	193	Models of Price Discrimination	233
<i>Fixed Costs and Minimizing Losses • Producing Where Total Cost Minus Total Revenue Is Minimized • Producing Where Marginal Cost Equals Marginal Revenue • Shutting Down in the Short Run • The Firm and Industry Short-Run Supply Curves</i>		Preconditions for Price Discrimination • Examples of Price Discrimination • A Model of Price Discrimination • Perfect Price Discrimination: The Monopolist's Dream	
Perfect Competition in the Long Run	199	10 Between Perfect Competition and Monopoly	238
<i>Zero Economic Profits in the Long Run • The Long-Run Adjustment Mechanism</i>		Monopolistic Competition	238
The Long-Run Supply Curve	205	<i>Characteristics of Monopolistic Competition • Product Differentiation • Price and Output Under Monopolistic Competition • Zero Economic Profit in the Long Run • Comparing Perfect Competition and Monopolistic Competition</i>	
<i>Constant-Cost Industries • Increasing-Cost Industries • Decreasing-Cost Industries</i>		An Introduction to Oligopoly	248
Perfect Competition and Efficiency	209	<i>Varieties of Oligopoly • Economies of Scale • Cost of Product Differentiation</i>	
<i>Productive Efficiency • Allocative Efficiency • Reviewing the Assumptions of Perfectly Competitive Markets</i>		Models of Oligopoly	251
9 Monopoly	214	<i>The Kinked Demand Curve • Collusion and Cartels • Price Leadership • Cost-Plus Pricing • Comparison of Oligopoly and Perfect Competition • Mergers and Oligopoly</i>	
Barriers to Entry	214	11 Regulation, Deregulation, and Antitrust	265
<i>Legal Restrictions • Economies of Scale • Control of Essential Resources</i>		Business Behavior and Public Policy	266
Revenue for the Monopolist	216	<i>Market Structure, Conduct, and</i>	
<i>Demand and Marginal Revenue • Revenue Curves</i>			
Firm Costs and Short-Run Profit Maximization	219		
<i>Price and Output if Costs Are Zero • Profit Maximization Using Ordinary Cost Curves • Short-Run Losses and the</i>			

Performance • Government Control of Business		Antitrust Laws	278
Public Regulation of Natural Monopoly	267	Origins of Antitrust Policy • Antitrust Law Enforcement • Per Se Illegality and the Rule of Reason • Problems with Antitrust • Mergers and Public Policy	
Theories of Economic Regulation	271	Competitive Trends in the Economy	283
Rail and Truck Regulation and Deregulation • Airline Regulation and Deregulation • Deregulation • Problems with Deregulation		Market Competition over Time • Reasons for the Growth of Competition: 1958 to 1980	

PART 4 Resource Markets **290**

12 Resource Markets	292	14 Unions and Collective Bargaining	336
The Demand and Supply of Resources	292	A Brief History of the Labor Movement	336
The Demand and Supply of Resources • Equilibrium and Resource Price Differences • Transfer Earnings and Economic Rents		Early Labor Organizations • A New Deal for Labor • The Labor Movement After World War II • Collective Bargaining and Other Tools of Unionism	
A Closer Look at Resource Demand	301	The Economic Effect of Unions	341
Demand for One Resource • Marginal Revenue Product • Marginal Resource Cost • Hiring Resources as a Monopsonist • Summarizing Four Market Possibilities • Shifts in the Demand for Resources • Price Elasticity of Demand • Optimal Resource Use		Inclusive, or Industrial, Unions • Exclusive, or Craft, Unions • Increase Demand for Union Labor • Bargaining in a Monopsonistic Labor Market • Union Objectives	
13 Labor Markets and Wage Determination	316	Recent Trends in Union Membership	354
Individual Labor Supply	317	Public Employee Unions • Competition from Nonunion Suppliers • Industry Deregulation • Unionization and Technological Change • The Urge to Merge	
Labor Supply and Utility Maximization • How Will You Spend Your Summer Vacation? • Nonwage Determinants of Labor Supply • Market Supply		15 Capital, Interest, Entrepreneurial Ability, and Profit	362
Why Wages Differ	325	The Role of Time in Consumption and Production	363
Tastes and Wage Differentials • Differences in Training and Education Requirements • Differences in Ability • Differences in Risk • Problems of Labor Mobility • Job Discrimination • Information Problems of Measuring Marginal Product		Production, Saving, and Time • Consumption, Saving, and Time • Optimal Use of Capital • Purchasing Capital • Investing in Human Capital • The Market Demand for Loans • Real Versus Nominal Interest Rates • Why Interest Rates Differ	
Functional Distribution of Income	333	Present Value and Discounting	376
		Present Value of Payment One Year Hence • Present Value for Payments in	

<i>Later Years • Present Value of an Income Stream • Present Value of an Annuity</i>		Poverty and the Poor	394
Entrepreneurial Ability and Profit	380	<i>Official Poverty Level • Public Policy and Poverty • Programs to Help the Poor • Expenditures and the Rate of Poverty</i>	
<i>Role of the Entrepreneur • The Entrepreneur Can Supply Other Resources • Why Entrepreneurs Often Invest in Capital</i>		Who Are the Poor?	400
Entrepreneurship and Theories of Profit	382	<i>Poverty Among Young Families • Poverty and Gender • Poverty and Race</i>	
<i>Entrepreneur as Broker • Entrepreneur as Risk Bearer • Entrepreneur as Innovator • Profit and the Supply of Entrepreneurs</i>		Poverty and Discrimination	405
16 Poverty and Income Distribution	390	<i>Discrimination in the Job Market • Affirmative Action • Discrimination in Transfer Programs?</i>	
The Personal Distribution of Income	390	Some Unintended Consequences of Income Assistance	408
<i>Distribution of Household Income • The Lorenz Curve • Why Do Family Incomes Differ?</i>		<i>Work Disincentives • Does Welfare Cause Dependency? • Poverty and Public Choice</i>	
		Welfare Reform	412
		<i>State Reforms • Negative Income Tax</i>	

PART 5 An Inside Look at Economic Institutions 418

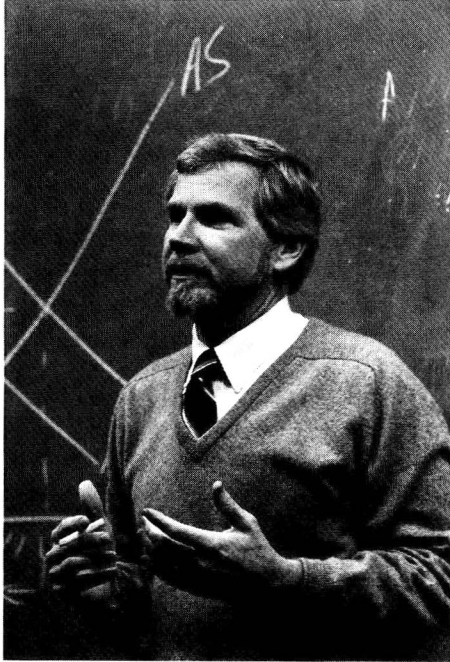
17 Inside the Household	420	18 Inside the Firm	444
Introduction	420	The Rationale for the Firm and the Scope of Its Operation	445
The Economics of Marriage	422	<i>The Firm Reduces Transaction Costs • Shirking and the Entrepreneur • The Scope of the Firm</i>	
<i>The Marriage Market • Gathering Information • Love and Marriage</i>		Contestability	453
Allocating Time Between Market Work and Household Work	425	Corporate Ownership and Control	454
<i>Household Work Versus Market Work • The Market Wage, Household Work, and Market Work • Deciding Who Does What</i>		<i>Managerial Behavior in Large Corporations • Constraints on Managerial Discretion • The Market for Corporate Control • A Glossary of Takeover Terms</i>	
The Economics of Children	428	19 Inside the Government	463
<i>The Supply and Demand for Children • The Farm Family • Inheritance and Industrialization • The Move to the City • Quantity and Quality of Children</i>		The Economy as a Game	464
The Changing American Family	436	<i>Fairness of the Game • Kinds of Games • Rules and Behavior</i>	
<i>Women in the Work Force • Divorce • The Rise of the One-Parent Household</i>		Public Choice in Direct Democracy	466
Demography	439	<i>Median-Voter Model • Logrolling • Cyclical Majority</i>	
<i>The Baby Boom • The Baby Bust • Following the Sun</i>		Representative Democracy	471
		<i>Goals of the Participants • Rational Ignorance • Distributions of Costs and</i>	

<i>Benefits</i>	
Rent Seeking	474
<i>Political Action Committees • Rent Seeking and Efficiency • The Underground Economy</i>	
Bureaucracy and Representative Democracy	482

<i>Ownership and Funding of Bureaus • Ownership and Organizational Behavior • Bureaucratic Objectives • Private Versus Public Production</i>
--

PART 6 The International Setting **488**

20 International Trade	490	21 The Soviet Economy	515
The Gains from Trade	491	Introduction to Alternative Economic Systems	516
<i>Reasons for International Specialization • A Profile of Imports and Exports • Absolute and Comparative Advantage • Production Possibilities Frontiers • The Gains from Trade</i>		<i>Planned and Market Socialism • Kinds of Coordination • Communism, Socialism, and the Soviet Union • Central Planning • Supply and Demand • Labor Markets</i>	
Trading on the World Market	497	Performance of the Soviet Economy	521
<i>World Price Is Above the Domestic Equilibrium Price • World Price Is Below the Domestic Equilibrium Price • The Rest of the World • Determining the World Price • The Gains from Trade Again</i>		<i>Economic Growth • Prices, Shortages, and Consumer Satisfaction • Problems with Agriculture • Secondary Effects of Socialist Property • Innovation</i>	
Trade Restrictions	502	Soviet Elite	529
<i>Tariffs • Quotas • Comparison of Tariffs and Quotas</i>		<i>Income Distribution • Soviet Elite • Intergenerational Mobility</i>	
Arguments for Trade Restrictions	507	Soviet Reforms	532
<i>National Defense Argument • Infant Industry Argument • Antidumping Argument • Protecting Jobs and Labor Income • Declining Industry Protection • Problems with Protection • Winners and Losers</i>		<i>Industrial Reforms • Allowing for Private Enterprise</i>	
		Glossary	
		Index	



William A.
McEachern

University of Connecticut
M. William Breadheft

William A. McEachern is professor of economics at the University of Connecticut, where he has taught principles of economics for more than a dozen years and has developed a series of annual workshops for teaching assistants. He has also taught at Arizona State University.

He received his Ph.D. from the University of Virginia and has published several books and monographs in public finance, public policy, and industrial organization. His research has also appeared in various journals, including *Economic Inquiry*, the *National Tax Journal*, *Kyklos*, *Public Choice*, and the *Journal of Industrial Economics*. Professor McEachern has advised federal, state, and local governments on policy matters and directed a bipartisan commission examining Connecticut's fiscal structure. He has talked before more than one hundred groups and has received the University of Connecticut's Faculty Award for Distinguished Public Service.

A stylized graphic of three overlapping leaf-like shapes in shades of gray, positioned in the top-left corner of the page.

PART ONE

Introduction to Economics

CHAPTER 1

The Art and Science of Economic Analysis

CHAPTER 2

Some Tools of Economic Analysis

CHAPTER 3

The Market System

CHAPTER 4

*The Economic Actors: Households, Firms,
and Governments*





THE ART and SCIENCE of ECONOMIC ANALYSIS

You have been reading and hearing about economic issues for years—the unemployment rate, the inflation rate, the price of oil, the federal deficit, higher tuition, the price of rock concert tickets. When the explanations of these issues go into any depth, your eyes probably glaze over, and you tune out the same way you do when the weather forecaster tries to provide an in-depth analysis of high-pressure fronts colliding with moisture carried in from the coast. Because of a negative experience with economics, some of you may have been dreading this course. Some of you may have had to work up your courage just to open this book.

What many people fail to realize is that economics is much more alive than the dry accounts provided by the news media. Economics is about making choices, and you make economic choices every day—choices about whether to live in the dorm or off-campus, take a course in accounting or one in music appreciation, pack a lunch or buy a Big Mac. Because you, as an economic decision maker, are the subject of this book, you know much more about economics right now than you realize. You bring to the subject a rich personal experience, an experience that will be tapped throughout the book to reinforce your understanding of the basic concepts. This chapter will introduce you to the art and science of economic analysis. Topics discussed in this chapter include:

- Scarce resources
- Unlimited wants
- Marginal analysis
- Scientific method
- Pitfalls of economic analysis