

MICROECONOMICS

PRIVATE AND PUBLIC CHOICE



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JAMES D. GWARTNEY

RICHARD STROUP

THIRD EDITION

MICROECONOMICS

PRIVATE AND PUBLIC CHOICE

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THIRD EDITION

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MYTHS OF ECONOMICS

PART FIVE INTERNATIONAL ECONOMICS AND COMPARATIVE SYSTEMS

Chapter	Number	Subject
1	1	"Economic analysis assumes people act only out of selfish motives. It rejects the humanitarian side of humankind."
2	2	"In exchange, when someone gains, someone else must lose. Trading is a zero-sum game."
3	3	"Rent controls are an effective method of ensuring adequate housing at a price the poor can afford."
6	4	"A good business decision-maker will never sell a product for less than its production costs."
9	5	"The prices of most goods are unnecessarily inflated by at least 25 percent as a result of the high rate of profit of producers."
12	6	"Automation is the major cause of unemployment. If we keep allowing machines to replace people, we are going to run out of jobs."
14	7	"Unions have increased the share of income going to labor."

OUTSTANDING ECONOMISTS

Chapter	Economist
10	Gary Becker
4	James Buchanan
5	John Kenneth Galbraith
7	Friedrich Hayek
16	Allen Kneese
3	Alfred Marshall
20	Karl Marx
2	David Ricardo
9	Joan Robinson
13	Joseph Schumpeter
1	Adam Smith
15	Lester Thurow

PERSPECTIVES IN ECONOMICS AND BOXED FEATURES

Chapter	Number	Subject
6	1	Economic and Accounting Cost—A Hypothetical Example
8	2	Product Obsolescence, Monopoly Power, and the Dynamics of Product Development
10	3	The Regulatory Effects of Motor Vehicle Inspection
12	4	Is Discrimination Profitable to the Employer?
12	5	The Minimum Wage—An Economic Appraisal
13	6	Can Agricultural Price Supports Make Farming More Profitable?
14	7	Competition from Products Supplied by Nonunion Labor—The Cases of the UAW and the Teamsters
15	8	Social Security and the Intergenerational Redistribution of Income
16	9	Prices and Quantities—How Energy Buyers Respond
16	10	Doomsday Through the Centuries
17	11	The Importance of Communal and Private Property Rights
18	12	Why General Motors Receives Better Signals than Congress
18	13	Dealing with Special Interests
19	14	Rich and Poor Nations—Are They Two Worlds Drifting Apart?

PREFACE

We believe that this is an exciting time to study and teach economics. Both economic events and advancements in economic theory are changing the introductory economics course. In some cases, recent theoretical contributions have supplemented our previous knowledge. In other instances, they have enlightened it; and in still others, they have corrected it. Since the real world is the experimental laboratory of the economist, events often contribute to our understanding of issues.

Our goal is to provide readers with a theoretical framework that will help them more fully understand the economic forces of our economy. We believe that this can be accomplished most effectively by integrating recent economic advancements into our more traditional models. We reject the idea that a principles course should merely teach students *what* economists think. We believe that it should equip them with economic tools and teach them *how* economists think. We seek to develop a logical and consistent economic framework that is based on the foundations of economics. Of course, there are areas where controversy abounds. In those instances, we seek to explain the nature of the controversy and the reasons for its presence.

THE THIRD EDITION

The emphasis on the economic way of thinking and core theory–application mixture is maintained in this edition. Without reducing the readability of the text, we sought to be more concise.

Chapter 6 contains additional material on production and more clearly illustrates the linkage between production theory and the firm's cost curves. Two chapters comparing and contrasting competition and monopoly follow

immediately. Survey data indicates that this is the format followed by most instructors. The intermediate cases of monopolistic competition and oligopoly are combined into a single chapter. The industrial structure section concludes with a new chapter on regulation and deregulation. The growth of social regulation, as well as recent moves toward deregulation in several industries, is discussed. The implications of public choice analysis are incorporated into our discussion of regulation.

The factor market section has been condensed. Chapter 13 on capital markets does contain a new feature on the capitalization of expected income from agricultural price support programs into the value of land with acreage allotments that should help enliven what is often rather dull material. The market failure—public choice section has been condensed into just two chapters. The chapter on international finance incorporates recent economic events and contains a new feature on the pros and cons of the gold standard. We think this material will be of interest to students while helping to clarify an issue where confusion often abounds.

Our objective in this revision has been to strengthen and expand the analysis set forth in earlier editions. We have aimed to maximize the pedagogical usefulness of *Economics: Private and Public Choice* by elucidating concepts in greater depth without sacrificing the breadth and clarity that distinguished the prior editions.

DISTINGUISHING FEATURES OF OUR APPROACH

Most of all, we believe that economics is a way of thinking. We seek to emphasize those points that will challenge students to think like economists. The following points are of specific interest in this regard:

1. *Economic Principles Are Presented in a Highly Readable Fashion.* Difficult language and terminology can often hinder successful learning, particularly of economic concepts. Feedback from both students and instructors has indicated that readability was one of the strengths of the prior editions. In writing this edition, we have built upon this strength, so as to minimize the obstacles faced by beginning students of economics.

Without sacrificing accuracy, we have sought to employ simple language. Simplicity, however, has not been substituted for depth. Rather, our aim is to highlight the power and accessibility of economic concepts. Where complex ideas are essential to our analysis, they are developed fully. We believe that the economics required for the 1980s can be challenging and applicable to the real world, and comprehensible to the student as well.

2. *Economic Reasoning and Its Applications Are Emphasized.* Although models, theories, and exercises are important, they are only tools with which to develop the economic way of thinking. Abstractions and mechanics are not stressed so as to obscure major concepts. We consistently emphasize the basics and their real-world applications.

3. *Economic Tools Are Applied to Both the Market and the Political Process.* Most textbooks tell students how an *ideal* market economy would operate, how real-world markets differ from the hypothetical ideal, and how ideal public policy

can correct the shortcomings of the market. In addition to discussing these three basic issues, we analyze what real-world public policy is *likely to do*. This central focus emphasizes both the power and the relevance of modern economics. Built on the pioneering work of Kenneth Arrow, Duncan Black, James Buchanan, Gordon Tullock, and others, the economic analysis of public, as well as private, choice fills a void many other textbooks fail even to acknowledge.

Students are often puzzled by the gulf between the ideal theoretical “solutions” of economists and the events of the real world. The economics of public choice bridges this gulf. Using the tools of economics, we can do far more than describe how the government can promote more efficient use of resources. We can illustrate why good politics sometimes conflicts with economic efficiency.

4. *The Role of the Human Decision-Maker Is Stressed.* To the student, it often appears that economists exclude human beings from the economic process. In most economics textbooks, business decision-makers are depicted as having perfect knowledge of demand and cost. Like computers, they always arrive at the maximum-profit solution. Government planners, knowing precisely the deficiency in aggregate demand and the size of the multiplier, simply increase government spending by the right amount to restore full employment. The employer, knowing the marginal productivity of each resource, utilizes each in exactly the proper proportion. Decision-making is treated as a mechanical exercise, removed from the real world. Throughout this book, we attempt to stress the importance of information, uncertainty, trial-and-error decision-making, adaptive expectations, and other factors that influence real-world choices. Economics is more than a set of guidelines. If students are to be convinced of its applicability, we must delineate the dynamic factors that influence and motivate human beings.

DISTINGUISHING FEATURES OF OUR PRESENTATION

We have employed several features of organization and design in order to make this presentation more interesting to students.

1. *Myths of Economics.* In a series of boxed articles, seven commonly held fallacies of economic reasoning are dispelled. Following a statement of each myth is a concise explanation of why it is incorrect. Each myth falls in a chapter containing closely related material.
2. *Perspectives of Economics.* These features provide additional detail on a specific topic or issue. They permit us to provide additional breadth on a topic or focus on the application of an economic principle without disrupting the normal flow of the text.
3. *Outstanding Economists.* Designed to foster the student’s lasting interest in economics, these articles present brief profiles of twelve economists who either have made major contributions to the field or are currently influencing economic thought. Although contemporary economists (for example, John Kenneth Galbraith, Lester Thurow, and Friedrich Hayek) are emphasized, such giants of economic history as Adam Smith, David Ricardo, Karl Marx, Alfred Marshall, and Joseph Schumpeter are also included. This series should serve both to

enhance the student's appreciation of economic history and to signify the contributions of many prominent present-day economists.

4. *Key Terms.* The terminology of economics is often confusing to introductory students. Key terms are introduced in the text in boldface type; simultaneously, each term is defined in the margin opposite the first reference to the term.

5. *Chapter Learning Objectives.* A statement of learning objectives, composed of the major concepts discussed, follows the text of each chapter. Students are encouraged to study the learning objectives before and after reading each chapter.

6. *Discussion Questions.* Intended to test the student's grasp of the economic way of thinking, a set of discussion questions concludes each chapter. These questions, and the discussions they provoke, provide students with the opportunity for self-testing and the review of important material.

SUPPLEMENTARY MATERIALS

The textbook is accompanied by a **Coursebook**. More than just a study guide, the **Coursebook** contains numerous true-false, multiple-choice, and discussion questions; problems for more detailed analysis and projects are also suggested. Almost every chapter contains a short article designed to supplement the classroom teaching of the important concepts presented in the text. In this series of readings, contrasting positions are often presented; discussion questions follow each article, challenging students to demonstrate their understanding of the material and to distinguish a sound argument from economic nonsense. As in the textbook, the emphasis is on helping the student to develop the economic way of thinking.

An **Instructor's Testbank** is also available. Over 2300 multiple-choice test questions, many of which have been pretested extensively, are included in the testbank. Each question carries a specific reference to the section of the textbook where the material tested by the item is covered. The testbank is also available on computer tape.

An **Instructor's Manual** is available upon request. It is divided into two parts. The first part contains teaching tips, sources of supplementary materials, and other information likely to be of assistance to instructors. The second part is a detailed outline of each chapter in lecture note form.

ACKNOWLEDGMENTS

A project of this type is truly a team effort. We sought to mold this edition into the shape desired by our users, both actual and potential. The comments of reviewers were extremely helpful. Their efforts made it possible for us to make what we consider to be a substantial improvement in the content and organization of the text.

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