

MICRO ECONOMICS

ROGER N. WAUD

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WITH "ECONOMIC THINKERS" ESSAYS BY
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PREFACE

One of this book's major aims is to demonstrate how principles of economics can be used to analyze real-world events and problems. Moreover, it presents these events and problems in the way that people usually encounter them—namely, via the news media. This approach is motivated by the view that a basic education in economic principles should develop the facility to apply an economic way of thinking to a news item of economic interest.

Economics professors are not readily available to the concerned citizen to help interpret the implications of the day's news. Those who report the news are often as befuddled by its meaning as those to whom they report. Clearly, it is not enough to know that economics is relevant. And it is not enough to understand basic economic principles spoon-fed from a textbook. Ultimately, a basic education in economic principles should develop a facility, indeed a habit, for disentangling and making sense out of the economic matters presented to us in our daily lives via the news media. Every chapter of this book uses real news reports to repeatedly demonstrate how to do this.

ADVICE FOR THE STUDENT

You don't have to have had a course in economics to be aware of economic problems. Newspapers, radio, and television bombard you with them daily. You no doubt are well aware of inflation, unemployment, and gasoline shortages. Tuition bills, finding a job, and just getting a few bucks to spend on a favorite pastime already have given you experience at economic problem solving. In short, you're not a novice to the subject of economics in the same way you might be to college physics. Nonetheless, economics is a rigorous subject. It should be studied in the same way that you would study a course in one of the sciences—a little bit *every day*.

Before reading a chapter always look at the learning objectives that are set out at the beginning. This will give you a brief outline of what you are about to read and what you want to learn from the chapter. Also, always read the news

policies in currently available texts, and not wishing to be evicted from the kitchen for taking up room and only complaining, I've decided to become a chef. Let me highlight what I think are the important features in my menu.

Microeconomics

Why, in students' minds, should microeconomics always play the role of the ugly stepsister to the sexy Cinderella, macroeconomics? I am convinced that it's because we economics teachers have not exploited the abundance of real-world problems that naturally lend themselves to microeconomic analysis. If students can be shown real-world applications of market supply and demand, elasticity, and marginal analysis, their enthusiasm for microeconomics can be kindled. That has been my experience at any rate. In putting together the news items used in this book, I was struck time and again by the abundance of news stories that are grist for microeconomic analysis. Indeed, the news item approach seems a natural way to give vitality to the study of microeconomics.

Throughout the microeconomics parts of the book, the main objective is to develop the standard tools of microeconomic analysis while at the same time showing how they may be applied to contemporary problems. Numerous applications of the basics of supply and demand are illustrated in Chapters 4, 5, and 6. Indeed, Chapter 6 is devoted entirely to applications involving natural gas shortages, rationing, black markets, rent controls, agricultural price supports, sales and excise taxes, and externalities. I feel that there is often a tendency to move beyond the basics of supply and demand too quickly without giving the student ample practice in application. Hence, at the end of Chapter 6, I have presented four separate news items for the student to analyze. Each is a lively and interesting illustration that is intended to readily engage the student's interest and appreciation for supply-and-demand analysis. The questions at the end of each are fairly extensive, giving the exercise the character of a case study.

There are certain areas of microeconomics where my own teaching experience has found other principles texts wanting. I have taken particular care to bolster these areas in this book. Such areas include: the comparison between pure competition and monopoly, the presentation of the factors pertaining to welfare loss from monopoly, and the discussion of the various sources of monopoly—all in Chapter 9; the discussion of oligopolistic market structures and the incentives for and consequences of price cutting and nonprice competition, Chapter 11; the evidence on the relationship between oligopoly and technological progress, and the relationship between market structure and antitrust policy, Chapter 12; the relationship between market structure and wage determination, Chapter 14; and the treatment of income distribution, poverty, and welfare policy, Chapter 16.

On Explaining Things

It may seem an odd pitch to make about a textbook, but this book places an emphasis on explanation. In recent years many economics principles texts seem to put a premium on being terse—even to the point of being “slick.” But there is a trade-off between brevity and explanation. Given the need to explain, the ideal is to be as brief as possible but not briefer than necessary. As a practical matter, books typically and unavoidably end up somewhat to one side or the other of the ideal. I have decided that, if I am condemned to err, I would opt for explaining

many curves and several compounded misunderstandings accumulated at the journey's end. Often the Checkpoints will include questions that require the student to apply a concept just learned to a particular aspect of the news item at the beginning of the chapter. Frequently, the Checkpoints provide grist for class discussion.

Learning Objectives

Learning objectives are listed and set off from the main text at the beginning of each chapter. They outline a plan of study for the chapter as well as provide an overview of what's to be done. After completing the chapter, the student can also use the list of learning objectives as a quick check to see whether the material in the chapter has been mastered or not.

Economic Thinkers

These are biographies of famous economists and others who have had a significant impact on economic events and economic thinking. They are not so much personal biographies as studies in the history of economic thought. Their major purpose is to highlight the development of economic thinking on major problems and concerns while indicating the significant role that particular individuals have played in this development.

Key Terms and Concepts

Terminology is unavoidably abundant in economics. In addition, words that have several meanings in common everyday usage often have a more precise meaning when used in economics. Such words, along with other important economic terms, appear in boldface type whenever they are first introduced and defined in the text. Key Terms and Concepts, at the end of each chapter, lists these. These terms and concepts are defined again in the Glossary at the end of the book.

Summaries

The Summaries at the end of each chapter are fairly comprehensive. They are intended to tie together the main concepts developed in the chapter as well as alert the student to areas that may require rereading.

Questions and Problems

Questions and Problems are also located at the end of each chapter. These are generally more complex and extended than the questions found in the Checkpoints. Some are almost case studies. Many may be readily used for class discussion. The News Items for Your Analysis appear after the Questions and Problems. The Checkpoints, the Questions and Problems, and the News Items for Your Analysis, with its Questions, provide significantly more in-text questions, problems, and case studies with questions than are provided by most economic principles texts currently available.

Figures, Graphs, and Tables

There is liberal use of real-world data that appear in tables and figures throughout the book. Quite often tables containing hypothetical data are used to illustrate particularly difficult concepts. Graphs and figures are also used

extensively—more *liberally than in most principles texts*. The captions describing each graph and figure generally begin with a brief summary statement followed by a reasonably complete description of what is portrayed.

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ONE

INTRODUCTION

1

ECONOMICS AND ECONOMIC ISSUES

ELECTRICITY USE TOPS FORECASTS

WASHINGTON, Aug. 17—Utility companies report demand may exceed the forecasts previously made in the wake of the surge in fuel costs caused by the Arab oil embargo. They fear unexpected strains on their capacity. Skeptical environmentalists argue that utility companies are crying wolf.

The evidence is deceptive. Last year a sizeable decline in use by industry, operating below capacity because of the recession, masked a substantial rise in residential and commercial use. Now with economic recovery, industrial use is on the rise.

Power companies claim to be caught in a pinch between rising electricity demand and fuel shortages. Diminishing gas supplies will put increased pressure on nuclear, coal, and oil supplies. This puts electricity users on a collision course with environmentalists. Air-quality standards in some areas practically rule out anything but low-sulphur oil, the most expensive of fuels.

Utilities claim a constricting net of environmental legislation and regulation is stifling their plant-building plans. They say plant costs have soared because of big wage settlements with construction unions and the extra expense of legally mandated safety and pollution-control gear. Utility companies have asked for huge rate increases to cover these costs. Aghast, rate-setting regulators have dug in their heels. Rate hearings have dragged on for 18 months or more. When increases are finally granted, the new rates will have already been outstripped by inflation. Investors, noting the havoc, have cooled on utility stocks, and share prices have slumped.

Environmentalists still consider utilities' demand projections too high, building plans excessive, and their encouragement of conservation unconvincing. However, other observers are wondering whether the cost of protecting the environment is outrunning the benefits. Some have also noted that the recent recession and inflation have further confused the issue.