



Spencer

Contemporary Economics

SEVENTH EDITION

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Contemporary Economics

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With the assistance of

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Worth Publishers, Inc.

FOR DARCY, ROBIN, AND CATHY

Contemporary Economics, SEVENTH EDITION

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Contemporary Economics

Preface

Students who are taking their first course in economics in the early 1990s need to acquire many of the same tools and techniques that introductory students have learned in previous decades. Much has changed, however, not just in the discipline of economics but also in the relative importance of topics and in the most successful methods of presentation. Major changes have been made in this edition in order to offer students a modern introduction to the principles of economics while providing a solid framework of basic theory.

Clearly the most effective and interesting way to learn economics or any other subject is by “doing” it. This book provides students with many opportunities to be active learners of basic theory and to “practice” economics as they learn it.

An introductory text should provide students with the fundamental theory they will need to do three things:

1. Understand matters of public policy
2. Evaluate conflicting opinions
3. Arrive at informed conclusions

This book seeks to achieve these objectives in a number of ways. It abounds with current issues and real-world examples, and it elucidates the several sides of ongoing debates.

New Content

The Seventh Edition of *Contemporary Economics* includes a number of exciting changes that are impor-

tant to students being introduced to economics in the 1990s:

Aggregate Demand/Aggregate Supply: The General Macro Model

A fundamental change in this edition is the early development (in Chapter 7) of the aggregate demand/aggregate supply model as the *general model* for all subsequent macroeconomic chapters. This provides students with a modern foundation for all the theory that follows. Monetary economics is developed fully *before* Keynesian economics, and Keynesian analysis is given complete, balanced, and modern coverage.

“Internationalization”—Emphasis on Global Economics

A world perspective prevails throughout the book. Explanations of linkages between domestic and foreign markets are woven into the text, not simply “added on,” and international repercussions of economic activity are discussed whenever appropriate. This enables students to gain an accurate understanding of how closely intertwined are international events and the U.S. economy.

Economic Growth

Economic growth is a major topic for the 1990s, and this edition contains a comprehensive chapter (Chapter 8) that will give students the understanding they

will need beyond this course. The chapter builds first on the production-possibilities curve, and then considers economic growth in terms of shifts in long-run aggregate supply, introduced in the aggregate demand/aggregate supply model developed in Chapter 7.

Today's Macroeconomic Theories

A new chapter (Chapter 17) presents a comprehensive survey of modern macroeconomic thinking. The chapter reviews and extends previously learned theories, explains how the various theories developed, and examines their relationships to each other. It also discusses the implications of policy activism versus nonactivism. This carefully balanced treatment of modern macroeconomic beliefs will help students to put into perspective much of what they've learned in the course.

Policy Analysis

This capstone chapter for the macroeconomics portion of the book (Chapter 19) uses theory in a very practical way. First, it develops a critical analysis of Reagan-era policies. Then it explores the causes of budget deficits and discusses the ongoing debate about the deficit. Finally, it takes an in-depth look at the trade deficit. This chapter shows students how the tools and insights they have acquired throughout the macroeconomic chapters are actually *used*.

Distinctive Features

Many topics have been revised and updated to reflect recent events. At the same time, this edition retains the distinctive treatment of many subjects that helps to differentiate it from other texts. Here are some examples, covering broad sections of the book:

Overview: Our Economic System

Unlike students in many other introductory courses, those beginning the study of economics often have little idea of what the subject is about. To provide the needed orientation, the first four chapters (Part 1) explain the nature and scope of economics. These chapters contain:

- A complete introduction to graphing and to the meaning and measurement of slope—greatly

expanded from previous editions and followed by practical applications

- Early explanations of resources, scarcity, trade-offs, and the economic goals of efficiency, equity, stability, and growth sought by all societies
- An informal and intuitive approach to the study of supply and demand
- Explanations of income distribution, measurements of inequality, and the different meanings of equity
- A comprehensive survey of the role of government in the economy

The overview chapters thus provide both an orientation and a platform for all subsequent chapters.

Macroeconomics

As previously mentioned, the aggregate demand/aggregate supply model is developed at the beginning of the presentation of macroeconomic theory in Chapter 7. *All* subsequent macroeconomic chapters make use of this model:

- It is used throughout the macroeconomic chapters (Part 2) as a *general* model of the economy.
- Monetary economics (Part 3) is developed before Keynesian economics using the aggregate demand/aggregate supply model. Modern monetary theory and policy are then examined within the framework of this model.
- Keynesian economics (Part 4) is given full coverage. The Keynesian aggregate expenditure/aggregate output model is formulated by emphasizing that it represents a special case of constant prices. The model is then linked to the aggregate demand/aggregate supply model for comparative analysis.
- A survey and extension of macroeconomic theories (Part 5), covering neo-Keynesianism, monetarism, rational expectations theory, and real business cycle theory, provides an ideal review of the theories presented in the course. This is followed by an analysis of today's most widely discussed economic problems:
 - macrodynamics of inflation, production, and employment
 - budget and trade deficits, the *J*-curve, and issues of policy activism

Thus, every aspect of modern macroeconomics suitable for treatment in an introductory course is covered.

Microeconomics

Deregulation, globalized financial trading, contestable markets, declining union membership, rapid changes in technology, and other developments are changing the way economics is practiced and taught. Microeconomic theory and policies reflect these changes, as can be seen in this edition in the following examples:

- The integrated treatment of production and cost functions, showing how the latter are derived directly from the former
- The graphic illustrations of changes in elasticity-revenue relationships along a demand curve
- A substantial treatment of utility theory with novel examples and applications, including complete diagrammatic treatment of the diamond-water paradox and Lerner's equi-income theorem
- Today's views on the positive as well as negative effects of oligopoly
- An extension of factor-input theory to incorporate imperfect competition

Of course, microeconomic theory takes on more significant meaning when combined with today's complex issues and policies. This is done on an extensive scale in a number of chapters. Some of the many important topics covered include:

- Agricultural policies and decoupling proposals for the 1990s
- Public-choice theory, voting theory, and merit-goods pricing
- Industrial organization and its link to antitrust policy
- Regulation theory, pricing criteria, and deregulation policies
- Labor market analysis, discrimination, and the effects of unionization
- Privatization of social security; policies to alleviate poverty; the economics of a free market in drugs; and a study of health-care economics, including problems of adverse selection and moral hazard

I have endeavored to present every aspect of theoretical and applied microeconomics at a level suitable for introductory students.

International Economics and the World's Economies

Global economic concepts and issues are integrated throughout the text. In addition, major specialized topics of international importance are given specific attention in separate chapters. Among the distinctive ones are:

- Comparative advantage and its relation to the strategic trade policy thesis
- A self-contained explanatory model of the balance of payments and a comprehensive survey of the foreign exchange market
- Pacific Rim economic development, focusing on the economies of Hong Kong, Singapore, South Korea, and Taiwan
- Socialism in transition and the new market socialism
- Economic reforms in the Soviet Union and China, including the possible economic effects of China's recent crackdown on the pro-democracy movement

Application of Theory

Theory is the skeleton of economics, and policies are its flesh and blood. This book contains a number of features that help bring economics to life for students:

Economics Live

Timothy Tregarthen has written the "Economics Live" essays that appear at the end of most chapters. These essays apply theory to current economic problems in an interesting and engaging way, offering immediate application of the basic ideas in the chapter.

Economics at Work

"What do economists *do*?" students often ask. Suzanne and Timothy Tregarthen have interviewed young professionals who use economics in their work. Their essays, "Economics at Work," show stu-

dents some of the many career opportunities that exist in economics. These essays are presented topically and describe career opportunities in such diverse areas as business reporting, teaching, government work, and economic forecasting, among others.

Notable Economists: History of Thought

Economics has a long and rich intellectual heritage. Suzanne Tregarthen has written a number of essays on leading economists of the past and present. She not only describes their contributions to the field but also provides fascinating information about their personal lives.

Economics in the News

The many ways in which economics influences current events can be interesting and often surprising. Numerous brief news items, positioned at appropriate points within chapters, reinforce the practicality and relevance of the topics under discussion.

Learning and Teaching Aids

The book's learning and pedagogical features continue to be presented in a variety of useful and interesting ways. They include:

Previews

Preview material at the beginning of each chapter helps to orient students by giving them a perspective on what they're reading. Each chapter begins with Chapter Topics—a list of the main heads in the chapter and a quick guide to what the chapter is about. This is followed by a Learning Guide—a few broad questions that will give students a clear focus on what to look for when reading the chapter.

Intra-Chapter and Chapter-End Summaries

Several longer chapters contain a "Summary Thus Far" near the middle of the chapter. These provide a convenient stopping point for lectures as well as an opportunity for students to reinforce their understanding before they continue. In addition, there is a point-by-point summary of all the main ideas and concepts at the end of each chapter.

Comprehensive Dictionary of Economic Terms and Concepts

Each technical term and concept is defined when first introduced, and is frequently defined again when used in subsequent chapters. These definitions (and numerous others) are catalogued, usually with brief examples and cross-references, in a dictionary at the back of the book. Printed on tinted paper to make it readily accessible, the dictionary is much more than a mere glossary—it is one of the most comprehensive dictionaries of economics available today. Students find it a valuable resource.

Supplements for the Student

The Seventh Edition offers a complete package of learning tools for the student:

Study Guide

The greatly revised *Study Guide*, by Eric Blankmeyer and Jack Mogab (Southwest Texas State University) and Muriel Converse, helps students to learn the material in the text, reinforce their knowledge, and test their understanding. The *Study Guide* has been painstakingly prepared to help *all* students, from those who are having difficulty with the subject to those who can easily grasp the material and wish to test their skills to assure complete mastery. Each *Study Guide* chapter contains the following:

Key Point Review This is a concise summary of the main ideas in each chapter of the textbook.

Learning Objectives These objectives help students to identify the most important concepts in each chapter. Each objective is keyed to questions in the *Study Guide* and to page numbers in the textbook.

Key Terms Students use the terms listed at the beginning of the exercise to complete fill-in statements, and thereby review the terminology in the chapter.

Objective Test Questions A set of true-false and multiple-choice questions covers all important points in the chapter.

Problems and Applications; Questions to Think About *Problems*—many based on real-world events—are posed that challenge students to apply what they've learned to issues of current concern. There are tables to complete, graphs to be drawn and

interpreted, and exercises designed to help students consolidate their understanding of key ideas. Each *Study Guide* chapter ends with thought-provoking *questions* that require critical-thinking skills as well as knowledge of economics.

Answers to *Study Guide* questions and page references to the relevant material in the textbook are provided so that students can check their work and reread the textbook when needed.

Free Subscription to *The Margin*

The Margin, a widely read economics magazine, is published during the fall and spring semesters. Under the editorship of Timothy Tregarthen of the University of Colorado at Colorado Springs, it is written specifically for economics students and is available by paid subscription. However, students purchasing new copies of this edition of *Contemporary Economics* will receive a *free* subscription. Many professors report that the magazine, whether used in the classroom or read by students on their own, is a superb tool for enriching the content of economics courses. An instructor's guide helps to incorporate each issue of *The Margin* into the course.

Contemporary Economics Graphics Tutorial

Comprehensive tutorial software has been developed by Richard Alston and Wan Fu Chi (Weber State College) expressly for *Contemporary Economics*. These tutorials help students to learn concepts, reinforce their understanding, and develop their problem-solving skills.

Here is the basic structure of the system:

- The first set of programs covers general introductory material that can precede either the macroeconomics or microeconomics portion of the course. These programs include coverage of graphing, opportunity cost, production-possibilities curves, and the laws of supply and demand.
- The next set of programs covers basic macroeconomic theory. The programs include the aggregate demand/aggregate supply model; the income-expenditure (or basic Keynesian) model; and the uses of these models in analyzing changes in the money supply, prices, interest rates, unemployment, tax rates, and other economic variables.
- The last set of programs covers basic microeco-

nomics theory. Topics covered include elasticity, utility theory, production and cost functions, perfect competition, monopoly, and imperfect competition.

This easy-to-use software is available for use on IBM and true compatibles and Macintosh computers.

Supplements for the Instructor

Instructor's Resource Manual

The *Instructor's Resource Manual* provides a detailed outline of each chapter, which is helpful for planning lectures. This manual also contains learning objectives and suggested answers to the end-of-chapter questions and to the questions at the end of the Economics Live essays.

Test Bank

Few test banks in economics meet *all* the criteria for multiple-choice questions established by testing experts. The test bank available to adopters of *Contemporary Economics* does. For those who are interested, the criteria are listed in the preface of the *Test Bank*.

Numerous new questions have been added and others have been revised to reflect the changes in the text. There are approximately 2,500 five-choice multiple-choice questions and 400 true-false questions. More than 85 percent of the questions require analysis, application, or interpretation of concepts or data. Fewer than 15 percent require students to recall factual or descriptive information. Four ready-made model examinations covering each part of the text are also provided in the *Test Bank*.

CompuTest: Computerized Test-Generation System

The questions in the *Test Bank* are available on disks (for IBM and true compatibles and Macintosh computers) for quick and easy generation of exams. Instructors can add their own questions, edit the existing questions, and print out different versions of an exam. The *Test Bank* and test-generation system include many questions that use graphs.

Color Transparencies

A full set of color acetate transparencies of the key graphs, charts, and diagrams in the text is available to adopters for use on an overhead projector.

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Suggested Outlines for One-Semester Courses

Chapter	Macro- economic emphasis	Micro- economic emphasis	Balanced macro/micro emphasis	Problems and policy emphasis
Introduction: Getting Started in Economics	●	●	●	●
1. Our Mixed Economy: Resources, Goals, and Institutions	●	●	●	●
2. The Laws of Supply and Demand: The Price System in a Pure Market Economy	●	●	●	●
3. The Private Sector—Household, Business, Foreign	●	●	●	●
4. The Public Sector—Government: Public Choice and Taxation	●		●	●
5. National Income and Wealth: Measuring the Nation's Economic Health	●		●	●
6. Monitoring the Economy: Business Cycles, Unemployment, and Inflation	●		●	●
7. The Self-Correcting Economy: Aggregate Demand and Aggregate Supply	●		●	●
8. Economic Growth: Increases in Long-Run Aggregate Supply	●		●	●
9. Money, Financial Markets, and the Banking System	●		●	●
10. Banking Institutions: Money Creation and Portfolio Management	●		●	●
11. Central Banking: Tools of Monetary Policy	●		●	●
12. Money and Prices: Understanding Monetary Policy	●		●	●
13. Lapses from Full Employment: Introduction to Keynesian Economics	●		●	●
14. Income and Employment Determination: The Income-Expenditure and Income-Price Models	●		●	●
15. Fiscal Policy and the National Debt	●		●	●
16. Money, Interest, and Macroeconomic Equilibrium	●		●	●
17. Today's Macroeconomic Theories: Keynesianism, Monetarism, Rational Expectations Theory, and Real Business Cycle Theory	●		●	●
18. Dynamics of Inflation, Output, and Unemployment	●		●	●
19. Policy Analysis: Recent American Domestic and International Experiences	●		●	●
20. Working with Supply, Demand, and Elasticity: Some Practical Applications		●	●	●
21. Looking Behind the Demand Curve: Utility and Consumer Demand		●		
22. Costs of Production		●	●	
23. Perfect Competition: Criteria for Evaluating Competitive Behavior		●	●	
24. Monopoly Behavior: The Other End of the Competitive Spectrum		●	●	
25. The Real World of Imperfect Competition		●	●	
26. Hiring the Factors of Production: Marginal Productivity and Income Distribution		●		
27. Determination of Factor Prices		●		
28. Stability, General Equilibrium, and Welfare Economics		●		
29. Our Farm Problem: Agriculture in Transition		●		●
30. Public Choice and Merit-Goods Pricing: Improving Public-Sector Efficiency		●	●	●
31. Industrial Organization and Antitrust: Structure, Conduct, Performance, Policy		●		
32. The Economics of Regulation		●	●	●
33. Human Resources: Labor Markets, Discrimination, Unions	●	●	●	●
34. Economics of Social Problems: Insecurity, Poverty, Drugs, Pollution	●	●	●	●
35. International Trade: The Commerce of Nations	●	●	●	●
36. International Finance: The Payments of Nations	●	●	●	●
37. Economic Development: The Less Developed and Newly Industrializing Countries	●	●	●	
38. Marxism and Socialism	●	●	●	
39. Market Socialism and Economic Reform: The Soviet Union and China	●		●	

● = Recommended chapters.

● = Optional chapters, time permitting.

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