




ECONOMICS

FIFTH
CANADIAN
EDITION

McConnell

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Brue

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Pope



ECONOMICS

FIFTH CANADIAN EDITION

PRINCIPLES, PROBLEMS, AND POLICIES

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ECONOMICS: PRINCIPLES, PROBLEMS, AND POLICIES

Fifth Canadian Edition

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Based as it is on the eleventh U.S. (1990) edition of *Economics*, it is useful to start our fifth Canadian edition preface with the eleventh edition's first paragraph.

This eleventh edition of *Economics* is the most extensive revision since the book was first published in 1960. The sweeping character of this revision reflects a number of intertwined considerations. First, the publisher prepared two detailed questionnaires concerning the principles course to provide a broad "factual" background for the revision. One questionnaire of a quite general nature was designed to determine what instructors desired in a textbook for the 1990s. The second questionnaire was directed specifically to users of the tenth edition of *Economics*, asking them to indicate their likes and dislikes, to assign priorities to various topics, to evaluate pedagogical aids, and to solicit suggestions for improvement. Second, detailed reviews were obtained from fifty economists. Some of these were current users of the text; some were not. Many provided complete reviews of the entire text; a few contributed more specialized reviews of particular subject matter areas. In a number of instances revised chapters were sent back to reviewers for further assessment. Third, a senior editor at McGraw-Hill undertook the task of reading the most heavily revised chapters from the standpoint of the intelligent layman. This yielded a myriad of suggestions that were useful in improving both the organization and presentation of material in these chapters. Last, and perhaps most importantly, a new co-author has joined the project, bringing with him an abundance of new ideas relating to content, organization, and pedagogy.

Over and above this very extensive work on the eleventh edition, a dozen Canadian economists reviewed our fourth edition. We trust that the outcome of this detailed revision is a text that is clearly superior to its predecessor.

The basic purpose of the text remains the same: to introduce the beginning economics student to those principles essential to an understanding of fundamental economic problems and the policy alternatives society may utilize to contend with these problems. It is hoped that the ability to reason accurately and objectively about economic matters and the development of a lasting interest in economics will be two valuable by-products of this basic objective. Our intention remains that of presenting the principles and problems of economics in a straightforward, logical fashion. To this end great stress continues to be put upon clarity of presentation and organization.

THE FIFTH EDITION

There are three major themes or endeavours that permeate the current revision.

Macroeconomics Perhaps the most pervasive controversies in economics over the past decade or so have been in the area of macroeconomics. Hence, a great amount of effort has been expended to rewrite and restructure the chapters dealing

with this topic. An incomplete list of the changes incorporated in this fifth edition is as follows:

1. The aggregate demand–aggregate supply model has been extensively reworked to stress the difference between the determinants of the shapes of the aggregate demand and aggregate supply curves and the various curve shifters or non–price-level determinants of the curves.

2. We have sought to integrate more fully the aggregate demand–aggregate supply model throughout the text.

3. We have emphasized the strong intellectual ties of monetarism and rational expectations theory to classical economics.

4. The differences in the competing macro paradigms have been brought into much sharper focus. These include differences in assumptions, analytical conclusions, and policy prescriptions. Finally, the locations of the various macro chapters have been significantly altered as follows:

- a. Money, Banking, and Monetary Policy now follow National Income, Employment, and Fiscal Policy.

- b. Chapter 21 (formerly Chapter 25), Equilibrium Domestic Output in the Keynesian Model, has been considerably shortened through transfer of the derivation of the consumption function and the investment-demand schedule to the previous chapter (20) and through fiscal policy now being dealt with in its entirety in the following chapter (22).

- c. The fiscal policy chapter has itself been shortened through the transfer of the analysis of budget deficits and the public debt to a new chapter (28), which follows money and monetary policy.

- d. The chapter on the inflation–unemployment trade-off (27) now follows monetarism and rational expectations (26).

We believe that this reorganization will substantially enhance student understanding of Chapters 27 and 28.

Modern topics As will become clear from our ensuing chapter-by-chapter summary of changes, we have made a special effort to add modern topics to *Economics*. Just a few examples of such topics are economics of crime, Coase theorem, median voter model, excess burden of taxes, Canada–United States Free Trade Agreement, anti-dumping duties, intervention in exchange markets by the G-7 nations, pro-competitive and anti-competitive views of advertising, capital flight from the LDCs, impacts of airline deregulation, rent-seeking activity, index of economic indicators, real business cycle theory, and exchange rate complications of stabilization policies. In short, we have endeavoured to make *Economics* a book for the 1990s.

Pedagogy In this revision we have been especially alert for opportunities to improve pedagogy. To this end a number of new diagrams and tables have been added to recapitulate complicated discussions and to stress basic relationships. Tables 4-6, 13-1, 25-2, 25-3, 27-1, and 31-2 and Figures 16-2, 16-6, 24-2, 25-1, and 28-1 are illustrative. Many text examples have been recast to enhance reader interest; for example, long-time adopters will find that bread and drill presses have given way to pizzas and industrial robots in Chapter 2. We have carefully pruned and consolidated material that upon reflection seemed somewhat redundant or

simply too “wordy.” The Last Word minireadings have been relocated to enhance their visibility and use. End-of-chapter questions have been carefully revised and updated. *The Instructor’s Manual* has been revitalized with the addition of 650 new multiple-choice questions. Furthermore, questions are now grouped by topic or concept and are sequenced to match the outline of each chapter. This re-ordering of questions will facilitate the *Manual’s* usefulness in test construction. Chapter 1 contains a new appendix on the construction and interpretation of graphs. Other pedagogical improvements permeate the fifth edition package.

Previous users of *Economics* will immediately note that the text is a chapter shorter than in the previous edition. This was accomplished as follows. The fourth edition’s chapter on radical economics (Chapter 17) was deleted. The two chapters on economic growth (Chapters 32 and 33) were reconceived as one chapter. As a partial offset to this two-chapter reduction, a new chapter on budget deficits and the public debt (Chapter 28) has been added.

Let us now examine in more detail the changes that have been made on a chapter-by-chapter basis.

VOLUME I: MICROECONOMICS

Part 1/An Introduction to Economics

Chapter 1 on methodology has been thoroughly reworked and reorganized. The roles of inductive and deductive reasoning are clarified and treated earlier in the chapter, as is the difference between micro- and macroeconomics. The differences between positive and normative economics are made explicit and illustrated. The chapter now ends with a new section on “the economic perspective” wherein the roles of rational behaviour and cost–benefit comparisons are introduced. A new Last Word provides a factual profile of the Canadian economy. Finally, a new appendix on the understanding of graphic analysis has been added. Chapter 2 introduces a new application of the production possibilities curve focusing upon international specialization. A new Last Word analyses comparative advantage in down-to-earth terms.

Chapter 3 on demand and supply is now in Part 1 so that only this part need be included with Volume II, *Macroeconomics*, in the paperback split edition. At the same time, Chapter 3 has been reduced to a more manageable length through the transfer of the analysis of elasticity to Chapter 4 and the analysis of the burden of an excise tax to Chapter 16. The discussions of the determinants of demand and supply have been carefully reworked, and illustrations have been updated and extended. The Last Word on ticket scalping is new.

Part 2/The Economics of the Firm

We give considerable attention to microeconomics in general and to the theory of the firm in particular, since the concepts of microeconomics are difficult for most beginning students. The analysis of the various market structures is coupled with

a discussion of the social implications of each. The impact of each market arrangement upon price and output levels, resource allocation, and the rate of technological advance is carefully assessed.

Chapter 4, as previously noted, now includes the analysis of price elasticity. The discussion of income and cross elasticity of demand have also been shifted from the Last Word to the main body of the chapter. The discussion of the total revenue test for price elasticity has been modestly extended for greater clarity, and a second panel has been added to Figure 4-2 to reinforce the total revenue–price elasticity relationship. A new study of commuter rail transportation is summarized to illustrate the impact of time upon price elasticity of demand and to apply the total revenue test.

The section on prices fixed by law contains two new segments, one on the actual effect of rent controls on the supply of housing, the other on the expected economic effects of interest rate ceilings on credit cards. The somewhat difficult material on excise tax incidence has been shifted to Chapter 16. The major changes in the analysis of consumer behaviour are pedagogical. A new table (Table 4-6) explains the utility-maximizing rule by sequence of purchase, and a new end-of-chapter question ties the rule to a downsloping demand curve. A new Last Word deals with the diamond–water paradox.

In Chapter 5 on market structures and Canadian business a distinction is made between self-interest and selfishness.

In Chapter 6 the discussion of diminishing returns has been carefully rewritten for greater clarity and a short section has been added to explain shifts in the average cost curves. The material on diseconomies of scale has been reworked and updated, as has the Last Word on economies of large firm size.

The changes in Chapter 7 are mostly pedagogical in nature. For example, students are reminded of the factors that shift the short-run supply curve; the discussion of the exodus of firms from a competitive industry has been slightly extended; and Figure 7-6, which identifies the marginal cost curve as the firm's short-run supply curve, has been redrawn for greater clarity. There is a new Last Word on the theory of contestable markets. Chapter 8 on monopoly embodies several notable changes. The material on entry barriers has been reorganized and slightly expanded. A new diagram underscores the price–marginal revenue relationship. The discussion of price discrimination has been reorganized, and the diagram illustrating regulated monopoly has been reconceived. An extended end-of-chapter problem explores the relationships between price elasticity, total revenue, and marginal revenue.

The section on product differentiation in Chapter 9 has been redone to sort out explicitly the various aspects of differentiation and to add new examples. The material on advertising includes new empirical evidence and brings the pro- and anti-competitive views of advertising into sharper focus. A new Last Word employs the “prisoners’ dilemma” to explain why firms might spend too much on advertising.

In Chapter 10 the discussion of obstacles to collusion is now followed by a section that relates these obstacles to OPEC. The case study of the automobile industry has been substantially rewritten and updated, as have the sections on airline de-

regulation and social regulation. The new Last Word analyses the problem of deregulating the airline industry.

Part 3/Resource Allocation

In these three chapters, 11 to 13, emphasis in the discussion of distribution is generally in accord with the relative quantitative importance of the various market shares in our economy. Labour markets are accorded rather extended discussion, but we have not belaboured the analysis of rent, interest, and profits.

The changes in Chapter 11 on resource demand are primarily pedagogical. For example, new examples of changes in resource demand are included; the section on the profit-maximizing combination of inputs has been simplified; and a new quantitative end-of-chapter problem has been added. Chapter 12 on wage determination features a large number of modest changes. For example, the characteristics of purely competitive and monopolistic labour markets are made more explicit; rising opportunity costs are stressed in explaining upsloping labour supply curves; and the discussions of inclusive unionism and the minimum wage have both been slightly extended. In Chapter 13 the discussion of Henry George's single tax has been condensed and simplified, and Table 13-1 has been added to emphasize the wide range of interest rates that exist. New material on the loanable funds theory of interest has been included. The Last Word on the growth of interest payments has been updated.

Part 4/Current Economic Problems

Part 4 deals with largely domestic issues: the farm problem, the economics of inequality and poverty, and the problem of government's role. In each of these chapters an attempt has been made to (1) describe the historical and factual background of the problem, (2) analyse its causes and effects, (3) explore government policy, and (4) offer a thought-provoking discussion of public policy alternatives. Instructors may choose to use the chapters of Part 4 selectively.

Chapter 14 on the farm problem has been changed significantly. The section outlining the history of the farm problem has been extended through the 1970s and 1980s. The material on the rationale for farm policies has been tightened, and the discussion of farm policy now focuses primarily upon price supports and considers their international implications. The new Last Word is an analysis by the Economic Council of the problems facing Canadian agriculture, concluding with recommendations for changes in government policies. Chapter 15 on income distribution ends with a new Last Word arguing the case for a guaranteed income. Chapter 16 on the economic functions of government has been considerably revised. The chapter now examines important aspects of public finance and the theory of public choice. Specifically, it includes discussions of the optimal output of a public good; the Coase theorem; the excess burden of an excise tax; and the revealing of preferences through majority voting. In addition, the circular flow model has been reconceived to provide a better perception of how government affects the economy. The chapter summary has been reworked and expanded, as have the end-of-chapter questions. The new Last Word analyses public-choice policy-making.

VOLUME II: MACROECONOMICS

Part 5/National Income, Employment, and Fiscal Policy

In Chapter 17 an important new section on measuring the price level has been added prior to the discussion of nominal and real GDP. Other changes include a reworking of the chapter introduction, pedagogical improvements in the value-added table, the addition of exports and imports to the circular flow diagram, and an updating of the discussion of the underground economy. Finally, a new Last Word on the CPI has been added.

Chapter 18 features a new table and brief discussion that present international comparisons of unemployment and inflation rates. The section on cost-push inflation has been reworked for greater clarity and to stress the self-limiting character of such inflation. Other changes include clarifications in the sections on frictional and cyclical unemployment; the addition of specific data on part-time and discouraged workers; and a comparison of disaggregated unemployment rates for the 1982 recession year and the 1988 fuller employment year. The new Last Word gives the case *for* hyperinflation.

The purpose of Chapter 19 (formerly 23) has been altered. Rather than an overview of macroeconomics, it is now designed as a springboard for the macro theory that follows. Hence, much of the material in this chapter is new to the fifth edition. A new opening section stresses the importance of a macro model and the ensuing discussions of aggregate demand and aggregate supply elaborate non-price-level determinants, that is, the factors that shift the aggregate demand and supply curves. Fourth edition material on stabilization policies has been excised and repositioned in later chapters. The Last Word on Keynes is new.

The aggregate demand–aggregate supply comparison of neoclassical and Keynesian economics has been revised in Chapter 20 (formerly 24) in the interest of greater clarity and to emphasize that neoclassical economists envisioned that, with a stable money supply, the aggregate demand would also be stable. Other changes include the addition of a second panel to the neoclassical interest rate diagram to further explain why a rightward shift of the saving curve allegedly would not result in a surplus of savings. Students are also reminded that a price level change can cause a change in investment through the interest-rate effect. The section in which the aggregate demand curve is derived from the Keynesian expenditures model now incorporates discussions of the interest-rate and foreign-trade effects. Finally, a new Last Word introduces and discusses the leading economic indicators.

As noted earlier, Chapter 21 (formerly 25), Equilibrium Domestic Output in the Keynesian Model, has been considerably shortened. This should ease understanding of Keynesian employment theory. The chapter ends with an analysis of international economic linkages. The Last Word on the stock market is new.

Chapter 22 (formerly 26) on fiscal policy contains several notable revisions. Exports and imports are now included in the discussion of discretionary policy, and an entirely new section on fiscal policy in an open economy has been introduced. The discussion of the automatic stabilizers has been restated and condensed. The

budget deficit and the public debt have been moved to the new Chapter 28. Finally, a new Last Word discusses Ottawa's budgetary performance.

Part 6/Money, Banking, and Monetary Policy

Chapters 23, 24, and 25 in this edition appeared as Chapters 20, 21, and 22 in the fourth edition. In Chapter 23 the discussion of money market equilibrium has been expanded and clarified by incorporating the relationship between interest rates and bond prices. The chapter now features a fascinating Last Word on the widespread use of beer as money in Angola. Instructors will find two visible changes in Chapter 24. First, we have added a diagram showing the relationship between an initial new deposit in the banking system and the resulting multiple-deposit expansion of the money supply. Second, there is a new Last Word on bank creation of money on Pluto. The introductory material in Chapter 25 has been tightened so that the discussion moves quickly into how the Bank of Canada controls the money supply. In this regard, a new diagram has been added to help students better understand open-market operations. In particular, the diagram clarifies the distinction between the Bank of Canada's purchase of securities from a chartered bank and from the general public. Discussion of the Keynesian cause-effect chain of monetary policy is deferred to the section on "Monetary policy, equilibrium GDP, and the price level." The presentation of easy and tight money policies included in this section has been improved and Table 25-3 has been added to provide a recapitulation. The section dealing with the shortcomings of monetary policy has been tightened and recent policies are discussed. An important section on the linkages of monetary policy to the international economy has been included. Similarly, net exports have been added to Figure 25-4's summary of Keynesian theory.

Part 7/Problems and Controversies in Macroeconomics

In this fifth edition, Chapter 26 on monetarism and rational expectations theory (RET) has been regrouped with three other chapters to constitute a unit on problems and controversies in macroeconomics. Chapter 26 has undergone a thorough revision that includes a restatement of the monetarist transmission mechanism; the use of aggregate demand-aggregate supply analysis to explain the monetary rule and the Keynesian criticism thereof; and a linking of RET to the general rationality assumptions that underlie economics.

Chapter 27 on the inflation-unemployment relationship also embodies fundamental changes. Its new location after the money and banking chapters and the chapter on monetarism and RET allows students to grasp more easily the issues and policies examined therein. In terms of content, the introductory discussion of the Phillips curve has been condensed and the simple graphics of demand-pull and cost-push inflation have been deleted. New material on the slackening of inflation in the 1980s has been inserted. The "accelerationist" view of the Phillips curve is now recast as the natural-rate theory and the discussion is rewritten to distinguish between short-run and long-run Phillips curves. The model is now used to explain

disinflation as well as inflation. Material on the new classical distinction between short- and long-run aggregate supply curves is introduced, and demand-pull and cost-push inflation are now considered in this context. The model itself is treated as an outgrowth of the natural-rate criticisms of Keynesianism. The discussion of policy options for combatting stagflation has been greatly condensed. A new table summarizes and contrasts the views of Keynesians, monetarists, rational expectationists, and supply siders. The new classical “real” business cycle theory is the topic of the new Last Word.

Revisions in the new Chapter 28 on budget deficits and the public debt include a new graph showing the relationship of the debt and interest payments on it to GDP; new material on the deficit’s relationship to Canada’s increasing net international indebtedness; and a brief discussion of the new classical view of deficits. The new Last Word presents the view that high interest rates, quite apart from their effect on the budget deficit, are not the way to fight inflation.

Chapter 29 on economic growth is a consolidation of the fourth edition’s Chapters 32 and 33. Much of the material on growth theory has been omitted, and the treatment of the growth controversy has been greatly condensed. The discussion of the productivity slowdown has been revised.

Part 8/International Economics and the World Economy

Chapter 30 on comparative advantage and protectionism includes the following changes: a section on the “anti-dumping” argument for protection has been added; the agenda of the Uruguay Round of GATT negotiations is presented; and certainly not least, the Canada–United States Free Trade Agreement is discussed in detail. Moreover, the new Last Word continues the analysis of the FTA from a different perspective.

Chapter 31 on exchange rates and the balance of payments now includes a simplified balance of payments table—useful both as a summary of the much more detailed table, which has been retained, and for those wishing to see Canada’s position at a glance. Chapter 32 on foreign investment has been tightened and updated. More importantly, the Americans’ view of their own recent reversion to international debtor status is analysed in relation to Canada’s five-fold greater *per capita* net indebtedness.

In Chapter 33 on the less-developed countries the descriptive material that introduces the chapter has been condensed; a more diverse classification of nations is presented; the discussions of unemployment and labour productivity have been reworked; the “capital flight” problem is introduced; the treatment of the role of government in development has been extended and reconceived for a more balanced presentation; and the section on the LDC debt crisis has been entirely rewritten and augmented with a new diagram and table.

“Last Word” Minireadings

Many instructors have reacted with enthusiasm to the “Last Word” minireadings, which appear toward the conclusion of each chapter. These selections serve several purposes: some provide meaningful real-world applications of economic concepts;

others reveal “human interest” aspects of economic problems; and still others extend or challenge the concepts and interpretations of mainstream economics. In this edition we have repositioned the Last Words to integrate them more fully into the body of each chapter. Twenty-five of the thirty-three Last Words are new to the fifth edition and two others have been revised and updated.

ORGANIZATIONAL ALTERNATIVES

Though economics instructors are in general agreement as to the basic content of a principles of economics course, there are considerable differences of opinion as to what particular arrangement of material is best. The structure of this book is designed to provide considerable organizational flexibility. Though we have chosen to move from micro- to macroeconomics, there is no reason why the introductory material of Part 1 cannot be followed immediately by the macro analysis of Part 5. Similarly, in our judgment money and banking can best be taught after, rather than before, national income analysis. Those who disagree will encounter no special problems by following Chapter 18 with Chapters 23 to 25. One might also choose to locate Chapter 18 on macroeconomic instability after either Chapter 21 or 22.

Furthermore, some instructors will prefer to intersperse the microeconomics of Parts 2 and 3 with the problems chapters of Part 4. This is easily accomplished. Chapter 14, on the farm problem, may follow Chapter 7, on pure competition, and Chapter 15, on income inequality, may follow Chapters 12 and 13, on the distributive shares of national income.

Those who teach the typical two-term course and who feel comfortable with the book’s organization will find that by putting Volume I in the first term and Volume II in the second, the material is divided logically both in terms of quantity and level of difficulty between the two terms. For those instructors who choose to put more emphasis upon international economics it is suggested that Volume I and Part 8 be treated in the first term and Parts 5, 6, and 7 in the second. For a course based on three-quarters of work, we would suggest Parts 1 and 2 for the first quarter, Parts 5, 6, and 7 for the second, and Parts 3, 4, and 8 for the third. Finally, those interested in the one-term course will be able to discern several possible groups of chapters that will be appropriate to such a course. Tentative outlines for three one-term courses, emphasizing macroeconomics, microeconomics, or a survey of micro and macro theory, follow this preface.

STUDENT FRIENDLY: STUDY AIDS

As in its previous editions, *Economics* is highly student oriented.

1. Students who are comfortable with graphic analysis and a few related quantitative concepts are in an advantageous position to understand principles of economics. With this in mind a new appendix to Chapter 1 carefully reviews graphing, line slopes, and linear equations.

2. The introductory paragraphs of each chapter state objectives, present an organizational overview of the chapter, and relate the chapter to what has gone on before and what will follow.

3. Given that a good portion of any introductory course is devoted to terminology, terms are accorded special emphasis. In particular, each important term is in boldface type where it first appears in each chapter. We have tried to make all definitions clear and succinct. At the end of each chapter all new terms are listed in the “Terms and Concepts” section. Finally, at the end of the book a comprehensive glossary of some 900 terms is found. This glossary is also contained in the *Study Guide*.

4. We have taken great care to write the legends that accompany all diagrams in such a way that they are self-contained analyses of the relevant concepts. We believe this is a strategic means of reinforcing student comprehension.

Much thought has gone into the end-of-chapter questions. Though purposely intermixed, the questions are of three general types. Some are designed to highlight the main points of each chapter. Others are “open-end” discussion, debate, or thought questions. Wherever pertinent, numerical problems that require the student to derive and manipulate key concepts and relationships are employed. Numerical problems are stressed in those chapters dealing with analytical material. In this fifth edition we have made a special effort to provide more quantitative questions on the assumption that active student involvement is critical to understanding. Some optional “advanced analysis” questions accompany certain theory chapters. These problems usually involve the stating and manipulation of certain basic concepts in equation form. Answers to quantitative questions are provided in the *Instructor’s Manual*.

The fifth edition is accompanied by a myriad of supplements that we believe equal or surpass competing texts in terms of both quantity and quality.

Study Guide Professor Thomas Barbiero of Ryerson Polytechnical Institute has prepared the fifth edition of the *Study Guide*, which many students find to be an indispensable aid. It contains for each chapter an introductory statement, a checklist of behavioural objectives, an outline, a list of important terms, fill-in questions, problems and projects, objective questions, and discussion questions. An extensive glossary is found at the conclusion of the volume. The *Guide* comprises, in our opinion, a superb “portable tutor” for the principles student.

Economic Concepts *Economic Concepts* provides carefully designed programmed materials for all the key analytical areas of the principles course. While it has been conceived with *Economics* in mind, it can be used as an effective supplement with any mainstream text.

INSTRUCTOR FRIENDLY: THE SUPPLEMENTS

Instructor’s Manual The fifth edition *Instructor’s Manual*, prepared by Professor Mark Lovewell of Ryerson Polytechnical Institute, comprises chapter summaries, teaching tips and suggestions, learning objectives, chapter outlines, data sources with suggestions for classroom use, and examinations and problems. Answers to the text’s end-of-chapter quantitative questions are also found in the new *Manual*.

We trust that instructors—both those who have used previous editions of *Economics* and those adopting it for the first time—will find this *Manual* to be useful and time-saving.

Test Bank The new edition of *Economics* is supplemented by a test bank of objective questions. The *Test Bank* is comprised of over 3000 multiple-choice and true-false questions, which will appear in the fifth edition *Instructor's Manual*.

Examiner System The test bank is keyed to the computerized test service called the *Examiner System*. In particular, all of the multiple-choice and true-false questions are coded with computer numbers so that examinations and quizzes can be expeditiously prepared. Instructions on the implementation of the *Examiner System* appear in the *Instructor's Manual*.

DEBTS

The fifth edition has benefited from a number of perceptive reviews. The contributors, to whom we are especially grateful, are Professors

Michael Bradfield, Dalhousie University;

Sam Fefferman, Northern Alberta Institute of Technology;

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Ibrahim Hayani, Seneca College;

Lionel Ifil, Algonquin College;

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Peter Sephton, University of New Brunswick;

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As always, Statistics Canada has been most helpful in providing last-minute information and in sending printouts of material not yet published.

The success of this revision also depends in large measure on the work of the professionals at McGraw-Hill Ryerson Limited, in particular Jennifer Mix and Marilyn Nice; and freelancer John Eerkes.

CAMPBELL R. MCCONNELL
STANLEY L. BRUE
WILLIAM HENRY POPE

OPTION ONE: One-Term Course Emphasizing Microeconomics

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|--|--|
| <ol style="list-style-type: none"> 1 The nature and method of economics 2 An introduction to the economizing problem 3 Demand and supply 4 Consumer behaviour and elasticity (optional) 5 Capitalism, its market structures, and Canadian business 6 The costs of production 7 Price and output determination: Pure competition 14 Rural economics: The farm problem (optional) 8 Price and output determination: Pure monopoly 9 Price and output determination: Monopolistic competition | <ol style="list-style-type: none"> 10 Price and output determination: Oligopoly 11 Production and the demand for economic resources 12 The pricing and employment of resources: Wage determination 13 The pricing and employment of resources: Rent, interest, and profits 15 Income distribution: Inequality and poverty (optional) 30 International trade: Comparative advantage and protectionism 31 Exchange rates and the balance of payments 32 Foreign investment in Canada |
|--|--|

OPTION TWO: One-Term Course Emphasizing Macroeconomics

- | | |
|---|--|
| <ol style="list-style-type: none"> 1 The nature and method of economics 2 An introduction to the economizing problem 3 Demand and supply 5 Capitalism, its market structures, and Canadian business 16 The economic functions of government 17 Measuring domestic output, national income, and the price level 18 Macroeconomic instability: Unemployment and inflation 19 Macroeconomic analysis: Aggregate demand and aggregate supply 20 Neoclassical and Keynesian theories of employment 21 Equilibrium domestic output in the Keynesian model 22 Fiscal policy | <ol style="list-style-type: none"> 23 Money and banking in Canada 24 How banks create money 25 The Bank of Canada and monetary policy 26 Alternative views: Monetarism and rational expectations 27 The inflation-unemployment relationship: Keynesian, new classical, and supply-side views 28 Budget deficits and the public debt 29 Economic growth 30 International trade: Comparative advantage and protectionism 31 Exchange rates and the balance of payments 32 Foreign investment in Canada 33 Growth and the less-developed nations |
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OPTION THREE: One-Term Survey of Micro and Macro Theory

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|---|--|
| <ol style="list-style-type: none"> 1 The nature and method of economics 2 An introduction to the economizing problem 3 Demand and supply 5 Capitalism, its market structures, and Canadian business 6 The costs of production 7 Price and output determination: Pure competition 8 Price and output determination: Pure monopoly 9 Price and output determination: Monopolistic competition 10 Price and output determination: Oligopoly 11 Production and the demand for economic resources 12 The pricing and employment of resources: Wage determination 13 The pricing and employment of resources: Rent, interest, and profits 17 Measuring domestic output, national income, and the price level | <ol style="list-style-type: none"> 18 Macroeconomic instability: Unemployment and inflation 19 Macroeconomic analysis: Aggregate demand and aggregate supply 20 Neoclassical and Keynesian theories of employment 21 Equilibrium domestic output in the Keynesian model 22 Fiscal policy 23 Money and banking in Canada 24 How banks create money 25 The bank of Canada and monetary policy 26 Alternative views: Monetarism and rational expectations 27 The inflation-unemployment relationship: Keynesian, new classical, and supply-side views 28 Budget deficits and the public debt |
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Three Suggested Outlines for One-Term Courses ***xxix***

PART ONE AN INTRODUCTION TO ECONOMICS

1

1 The Nature and Method of Economics 3

THE AGE OF THE ECONOMIST Economics for citizenship
Personal applications

METHODOLOGY Descriptive economics Economic theory
Policy economics: positive and normative

PITFALLS TO STRAIGHT THINKING Bias Loaded terminology
Definitions Fallacy of composition Cause and effect: *post hoc* fallacy

THE ECONOMIC PERSPECTIVE

Last Word THE CANADIAN ECONOMY: A FACTUAL PROFILE

APPENDIX TO CHAPTER 1: GRAPHS AND THEIR MEANING

Constructing a graph Direct and inverse relationships Dependent and independent variables Other variables held constant Slope of a line Slope of a non-linear curve

2 An Introduction to the Economizing Problem 28

THE FOUNDATION OF ECONOMICS Unlimited wants Scarce resources

ECONOMICS AND EFFICIENCY DEFINED Full employment and full production Production possibilities table Production possibilities curve Optimal product-mix Law of increasing opportunity costs

UNEMPLOYMENT, GROWTH, AND THE FUTURE Unemployment and underemployment A growing economy Expanding resource supplies Present choices and future possibilities Real-world applications

FIVE FUNDAMENTAL QUESTIONS

THE “ISMS” Pure capitalism The command economy Mixed systems
The traditional economy

CHARACTERISTICS OF ALL ECONOMIES Extensive use of capital goods
Specialization Use of money

THE CIRCULAR FLOW MODEL Resource and product markets Limitations

Last Word ACCOUNTING OR PAINTING?

3 Understanding Individual Markets: Demand and Supply 55

MARKETS DEFINED

DEMAND Law of demand The demand curve Individual and market demand Determinants of demand Changes in demand Changes in quantity demanded

SUPPLY Law of supply The supply curve Determinants of supply
Changes in supply Changes in quantity supplied

SUPPLY AND DEMAND: MARKET EQUILIBRIUM Rationing function of prices Changes in supply and demand The resource market “Other things equal” revisited

A POWERFUL TOOL Applicability

Last Word **TICKET SCALPING: SIN AND THEOLOGY**

PART TWO THE ECONOMICS OF THE FIRM

81

4 Elasticity and Further Topics in the Theory of Consumer Demand 83

PRICE ELASTICITY OF DEMAND The price elasticity formula Refinement: midpoints formula The total-revenue test Characteristics Determinants of price elasticity of demand Some practical applications Elasticity of supply

APPLICATIONS OF SUPPLY AND DEMAND ANALYSIS Prices fixed by law

CROSS ELASTICITY OF DEMAND

INCOME ELASTICITY OF DEMAND

TWO EXPLANATIONS OF THE LAW OF DEMAND Substitution and income effects Law of diminishing marginal utility

THEORY OF CONSUMER BEHAVIOUR Consumer choice and budget restraint Utility-maximizing rule Algebraic restatement

MARGINAL UTILITY AND THE DEMAND CURVE

THE TIME DIMENSION The value of time Some implications

Last Word **THE WATER-DIAMOND PARADOX**

APPENDIX TO CHAPTER 4: INDIFFERENCE CURVE ANALYSIS The budget line: what is obtainable Indifference curves: what is preferred Equilibrium at tangency Digression: the measurement of utility Deriving the demand curve

5 Capitalism, Its Market Structures, and Canadian Business 122

PURE CAPITALISM Private property Freedom of enterprise and choice Role of self-interest Competition Markets and prices Limited government

FOUR BASIC MARKET MODELS Imperfect competition Determinants of market structure

THE BUYER'S SIDE OF THE MARKET

THE BUSINESS POPULATION Plants, firms, and industries

LEGAL FORMS OF BUSINESS ENTERPRISES Sole proprietorship Partnership Corporation Incorporate or not?

INDUSTRIAL DISTRIBUTION AND BIGNESS Distribution Bigness

Last Word **THE FINANCING OF CORPORATE ACTIVITY**

6 The Costs of Production 139

ECONOMIC COSTS Explicit and implicit costs Normal profits as a cost Economic, or pure, profits Short run and long run

PRODUCTION COSTS IN THE SHORT RUN Law of diminishing returns Fixed, variable, and total costs Per unit, or average, costs Marginal cost Shifting the cost curves