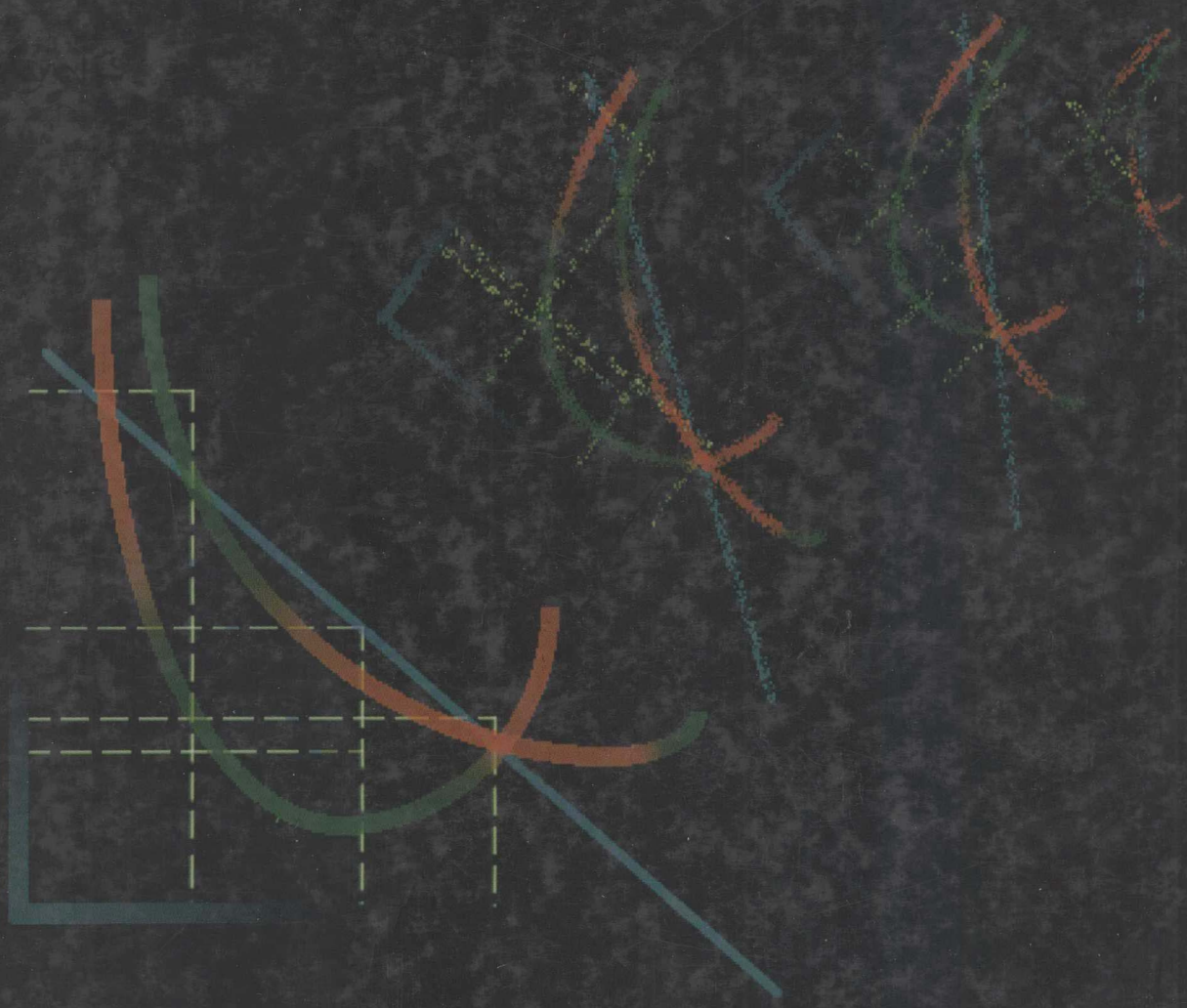
MICROECONOMICS

B. CURTIS EATON

DIANE F. EATON



SECOND EDITION

Microeconomics

Second Edition

B. Curtis Eaton

Simon Fraser University

Diane F. Eaton

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Second Edition

To Brett and Sarah

PREFACE

To the Student

Why do you sometimes find two or three gas stations at the same intersection? Why does the value of a new car plummet the instant you drive it off the lot? Why do we have bosses? Why do people have to spend so much time searching for an apartment in rent-controlled areas? Why do amusement parks often charge a whopping admission price to the park and almost nothing for the rides? Why does McDonald's break down the job of making hamburgers into so many little tasks and hire different workers to do each one? Why does IBM produce a whole spectrum of products? Why are some markets — such as the market for local telephone services — monopolized, and others — such as the markets for haircuts or carpet shampooing — highly competitive? What is the best way to alleviate the annoying traffic congestion that plagues so many North American cities?

As you work your way through this book, you'll discover the answers to these and many other questions. But microeconomics is not just a listing of specific economic questions and their answers. Rather, it is a systematic way to set out and solve virtually any question that you might encounter in everyday economic life. Our primary goal in writing this book is to help you learn how to formulate intriguing economic questions and then start finding the answers.

In Chapter 1, we explain the working methodology of the microeconomic theorist — not by talking about it, but by showing you how to create and explore a specific economic model. This "hands on" approach is used throughout the book and is reinforced by many in-chapter problems and end-of-chapter exercises aimed at engaging you in active, participatory reading. (We provide answers to the in-chapter problems at the end of the book.) Our philosophy is that the only way to learn microeconomics is to do it — every step of the way.

Doing economics well means understanding economic analysis thoroughly. We present all the standard topics of microeconomic analysis in a series of carefully sequenced steps. The narrative style of presentation means that each topic flows naturally from what came before it and leads smoothly into what follows. By working actively through the text and the accompanying problems, you will come away with a solid understanding of the major topics of microeconomics.

Of course, microeconomics is a field that is still changing — and that is its real challenge. We provide you with an overview of current research in representative areas,

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including the theory of the firm, the theory of oligopoly and market structure, the economics of information, and the address (or characteristics) approach to product differentiation. In exploring these topics, you will be able to reach the frontiers of microeconomic research — and to see just how much exciting work in microeconomics remains to be done.

To the Instructor

This book is intended for use in undergraduate courses in intermediate microeconomics. We do not use calculus in the text itself, where we rely on carefully explained graphic techniques. However, we do provide complete calculus footnotes.

The approximately 180 in-chapter problems, all of which are answered at the back of the book, are reinforced and extended by a similar number of end-of-chapter exercises. Especially difficult exercises are marked with an asterisk. You will find answers to all the end-of-chapter exercises in the *Instructor's Resource Book.* The *Instructor's Resource Book* also contains a series of easy-to-administer classroom experiments that illustrate the power of economic analysis and transparency masters for all graphs in the text. A *Test Bank* of multiple-choice questions is available on computer disk for the IBM PC and compatibles and in booklet form.

In the accompanying study guide, *Problem Solving in Microeconomics,* Second Edition, Nancy Gallini of the University of Toronto has done a superb job of providing supplementary material that will help the student to develop a thorough understanding of microeconomics. Each chapter contains a chapter summary, case studies, a list of key words, multiple-choice questions, and true-false questions. In addition, the study guide offers a wide range of useful and fascinating real-world problems designed to teach students how to think as economists do.

How to Use This Book

We have designed this book so that a number of differentiated courses can be taught from it. Note that chapters and sections of chapters that are marked with an asterisk in the table of contents and the text can be skipped with no loss of continuity. Note, too, that the order in which this material can be assigned is often quite flexible. For example, Chapter 6 (Choice Making Under Imperfect Information) can fit neatly just after Chapter 10 (The Theory of Perfect Competition), since it deals with both competitive insurance markets and Akerlof's lemons model. Alternatively, it can be used at the very end of the course, as an introduction to a set of issues that will be covered in detail in more advanced courses. To cite one further example, Sections 8.5, 10.8, and 11.10 make up a comparative institutional package that can be taught conveniently at any point after Chapter 11.

Chapters 1 through 5 and Chapters 8 through 11 form the core of a standard one-semester course. A number of differentiated courses that build on this core are described below.

- *Nonspecialized:*
  Suggested chapter assignments: 1 – 5, 8 – 11, 14 – 15
  Optional chapter assignments: 12, 16
- *Comparative institutional analysis, or property rights:*
  Suggested chapter assignments: 1 – 5, 7 – 11 (highlight Sections 2.3, 5.6, 8.5, 10.8, 11.8, 11.10)
  Optional chapter assignments: 6, 13
- *Labor economics:*
  Suggested chapter assignments: 1 – 5, 7 – 11, 14 (highlight Section 5.5)
  Optional chapter assignment: 16
- *Consumer theory:*
  Suggested chapter assignments: 1 – 5, 6 – 11, 16 (highlight Sections 3.3, 3.4, 4.10, 5.2)

On the Second Edition

Broadly speaking, the organization and content of the first edition are unchanged in the second edition. However, specific material in many chapters has been substantially reorganized, and all but four chapters have been completely rewritten. All these revisions are aimed at making the book more user-friendly for students. In addition, a number of other changes have been made in the interests of liveliness, clarity, and accessibility:

- The graphs have all been streamlined and relabeled.
- The mathematical notation has been thoroughly overhauled and simplified.
- The end-of-chapter exercises have been completely revised, and many new exercises that reinforce basic concepts have been added.
- New and up-to-date examples have been added throughout.
- Economic concepts that students typically find abstract or difficult are presented in terms of specific illustrations that are concrete and easy to understand.
- All of the general equilibrium material has been pulled together in one chapter.

Acknowledgments

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Reviewers

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Microeconomics

Second Edition

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