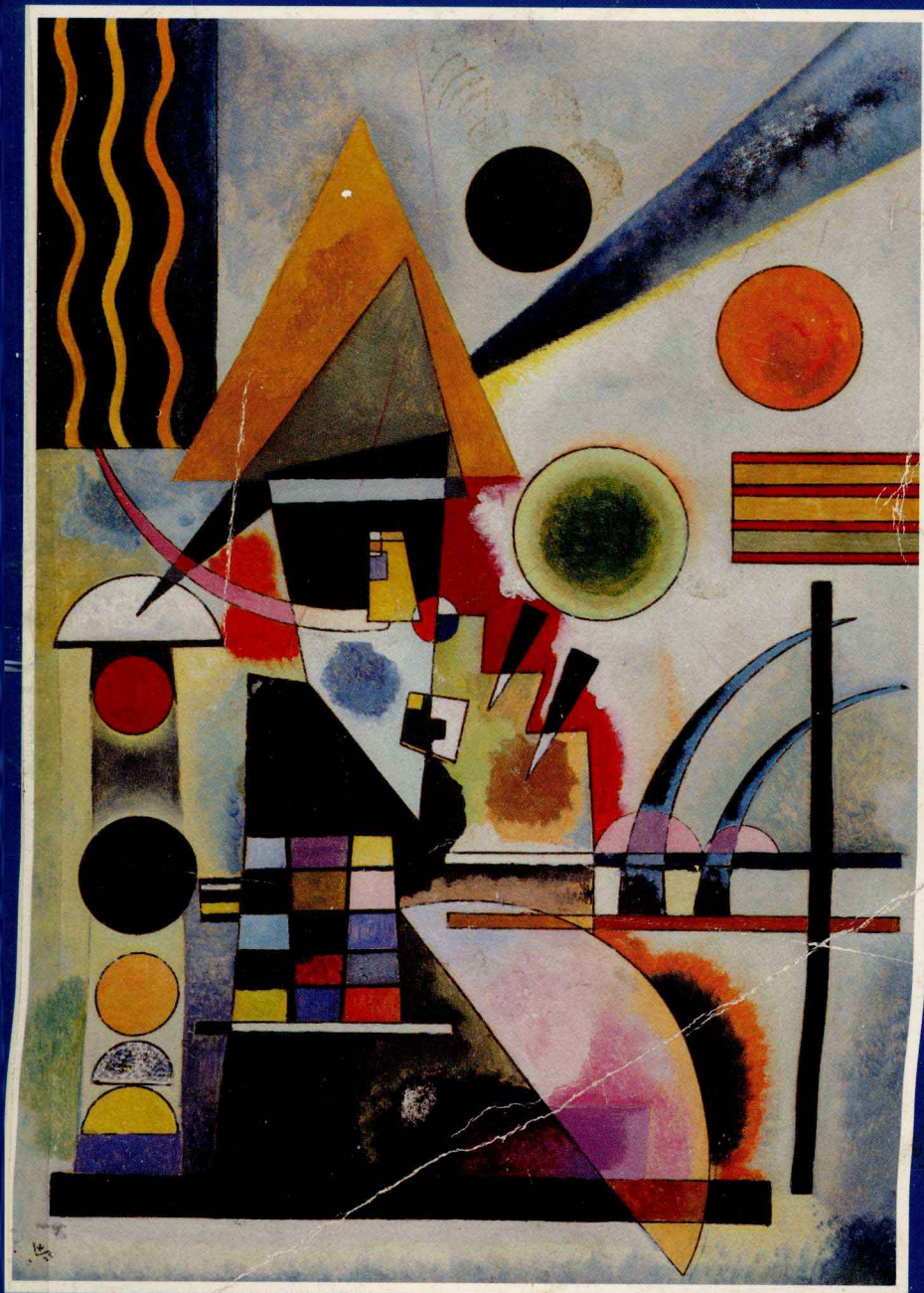


MICROECONOMICS

Dolan
Lindsey



Fifth Edition

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The Dryden Press

Chicago New York San Francisco Philadelphia Montreal Toronto London Sydney Tokyo

Acquisitions Editor: Elizabeth Widdicombe
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Copy Editor: Nancy Maybloom
Indexer: Leoni McVey
Compositor: York Graphic Services, Inc.
Text Type: 10/12 Plantin Light

Library of Congress Cataloging-in-Publication Data

Dolan, Edwin G.
Microeconomics/Edwin G. Dolan, David E. Lindsey.—5th ed.

Bibliography: p.
Includes index.
1. Microeconomics. I. Lindsey, David Earl. II. Title.
HB172.D65 1988 338.5 87-31421
ISBN 0-03-020397-X

Printed in the United States of America
890-032-98765432
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should be mailed to: Permissions, Holt, Rinehart and Winston,
Inc., 111 Fifth Avenue, New York, New York 10003.

Address orders:
111 Fifth Avenue
New York, NY 10003

Address editorial correspondence:
One Salt Creek Lane
Hinsdale, IL 60521

The Dryden Press
Holt, Rinehart and Winston
Saunders College Publishing

Cover Source: Wassily Kandinsky, *Shaking Balancement*, 1925, The Tate
Gallery, London. Copyright Artists Rights Society,
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Preface

Change Is the Only Constant

It has been a decade and a half since the authors first collaborated on an economics text. Those years have shown that in economics, change is the only constant.

Since our first effort to set forth the principles of economics for beginning students, economists have gained a better understanding of both the world at large and their own discipline. In macroeconomics, more is known about the dynamics of inflation and disinflation, the role of expectations in shaping economic behavior, and the interaction of the domestic economy with the world economy. In microeconomics, the contributions of public choice theory have lent a new perspective to many policy issues, the work of the modern Austrian school has brought new emphasis to the role of entrepreneurship, and long-established fields of economics such as antitrust policy, human resources, and income distribution have taken on new life.

But the economy has not stood still in the face of economists' improved understanding. Events have continued to pose new questions. Economists still disagree on such matters as the effects of the federal deficit, the proper strategy for monetary policy, the sources of volatility in securities prices and exchange rates, the reasons for differences in men's and women's average pay, and the effects of antipoverty policies, to name just a few areas of controversy.

The rapid pace of change in economic theory and reality makes teaching economics a challenge. Meeting that challenge requires a textbook that changes too. First, the book must bring the latest policy issues and theoretical topics into the classroom and explain them clearly. Second, the book must emphasize the ways of thinking that all economists use to attack new problems, even where they do not ultimately agree. Finally, the book must reflect ongoing innovation in pedagogical techniques so that the complexities of economics are made accessible to the beginning student.

This fifth edition of *Microeconomics* responds to the need for change with these major innovations:

1. **Feature: Focus on entrepreneurship.** A new chapter, Chapter 12, covers theories of entrepreneurship and the market process, including contributions of the modern Austrian school. Coverage of entrepreneurship is not limited to this special chapter, however. The role of entrepreneurship in the market economy is repeatedly stressed when discussing supply and demand, theory of the firm, industrial organization, and microeconomic policy.

Purpose: To show how the market economy deals with scarcity in a world in which change is a "given" and information is one of the key scarce resources.

Benefit: Students learn that microeconomics is more than a set of abstract geometrical exercises.

2. **Feature: Public choice economics.** Another new chapter, Chapter 19, covers public choice economics. As with the topic of entrepreneurship, the

influence of public choice theory is not limited to this chapter. Related topics, including theories of rent seeking, externalities, market and government failure, and privatization are developed in Chapter 5, near the start of the course, and in many of the applied micro chapters.

Purpose: To show that basic economic concepts apply to public as well as private choices.

Benefit: Provides a perspective on the strengths and limitations of democratic government in the sphere of economic policy.

3. **Feature: State-of-the-art pedagogy.** Enhanced teaching and learning aids and a new generic organization of boxed cases mean that the fifth edition of *Microeconomics*, like past editions, defines the state of the art in pedagogy.

Purpose: To help students see the forest as well as the trees.

Benefit: Students who understand economics as a way of thinking rather than just a grab bag of models retain more of what they learn in the principles of economics course.

Keeping a textbook like this up to date is not simply a matter of adding new material. Selective pruning is also necessary. In deciding what to eliminate, our overriding aim has been to focus on a few key models and concepts that will unify the student's way of thinking about economics. Input from many reviewers, users, and students has helped us in this task. In some cases, topics have been deleted when they were found repetitive or were used by only a minority of instructors. Other topics, such as farm policy, no longer appear as separate chapters but are grouped with related topics elsewhere.

Edwin G. Dolan and David E. Lindsey have collaborated on every edition of this book. In this edition, Lindsey has returned to the status of full coauthor. His wide knowledge of economic theory and insider's view of the policy process complement Dolan's experience in the classroom and as a government microeconomic analyst. Of course the views expressed in this book are those of the authors and do not necessarily reflect the views of the Board of Governors of the Federal Reserve System or other members of its staff. The following pages outline the approach of this book to the changing world of economics in more detail.

Organization of the Book

The Introductory Chapters

The book begins with a set of chapters that provide an overview of economics and the economy. As a group, these five chapters provide the background that students need to proceed with either a macro-first or micro-first course sequence.

Chapter 1, "What Economics Is All About," focuses on scarcity and choice as the issues that define the discipline of economics. It gives an idea of how economists, as people, think, confront disagreement, and work in academic, business, and government careers. Chapter 2, "Exchange and Production," looks at the central problems of what, how, and for whom that every economy faces. Chapter 3, "Supply and Demand," presents the basic model on which

both micro and macro chapters build, stressing reactions to disequilibrium as well as equilibrium. Chapter 4, “The Role of Business: The Firm, Financial Markets, and Corporate Control,” looks at current issues, such as takeovers and insider trading, as well as traditional material relating to the organization of the firm. Chapter 5, “The Role of Government: Market Failures, Rent Seeking, and Privatization,” uses the concept of market failure to discuss such topics as provision of public goods and control of externalities and uses the concept of rent seeking to explain why government failures also sometimes occur.

Core Chapters and Applications

The central objective in revising the micro chapters of this text has been to blend new perspectives in microeconomics with the traditional core of neoclassical maximizing models. This has meant reorganization of existing material, addition of new material within several chapters, and addition of two new chapters.

Chapter 6, “Applying Supply and Demand,” provides new applications of elasticity, including the issue of tax incidence. Chapter 7, “Rational Choice and Consumer Behavior,” gives expanded attention to the general notion of rational choice as background for the specific topic of consumer choice. The chapter now also covers the topics of consumer and producer surplus.

The first section of Chapter 9, “Supply under Perfect Competition,” has been rewritten to survey the varieties of market structure before examining perfect competition as a special case. Topics in the next two chapters have been regrouped. Regulated natural monopolies are now covered together with other monopoly topics in Chapter 10, “The Theory of Monopoly.” Chapter 11, “Industrial Organization, Monopolistic Competition, and Oligopoly,” now groups the topics covered in its title plus the subject of cartels.

A distinguishing feature of this text is its emphasis on the role of entrepreneurship in the economy. In this respect, it draws extensively on the modern Austrian theory of entrepreneurship and the market process. The importance of entrepreneurship as a force of change in the economy is developed as a counterpoint to the neoclassical notion of static equilibrium beginning in Chapters 2 through 5 and continuing through all of the chapters. The various threads of the discussion are drawn together in the new Chapter 12, “Entrepreneurship and the Market Process.”

The influence of public choice theory can be seen at many points in the text. Chapter 5, which introduces the role of government, raises the notions of rent seeking, government failure, and privatization, all prominent themes of public choice theory. The new Chapter 19, “The Theory of Public Choice,” shows how many policy actions taken by government can be understood in terms of the rational behavior of voters and government officials. The influence of the public choice approach can also be seen in a number of the other applied micro chapters. For example, public choice concepts are used to explain the prevalence of protectionist policies in Chapter 20, “International Trade and Trade Policy.”

There has been some pruning in the micro chapters. The previously separate chapters on antitrust and regulation have been combined into one. There is no longer a separate chapter on farm policy, although much of this material has been retained in the form of case studies in Chapters 3, 5, and 11. Finally, we have added an abbreviated version of “Careers in Economics” from the *Study Guide* as an appendix to the text.

Pedagogy

Many innovative features of earlier editions of *Microeconomics* have become industry standards. An example is multilevel vocabulary reinforcement, with boldface terms, marginal definitions, and an end-of-book glossary. While others play catch-up, the process of innovation and refinement continues in this new edition of Dolan/Lindsey.

Bracketing

One of the most solidly established techniques of effective pedagogy is that of *bracketing*. Every good classroom lecturer uses bracketing in the form of “Here’s what we are going to say; here it is in detail; here is what we just said.” The textbook equivalent is chapter preview and review. Sheer volume of preview and review material counts for less than do the care with which the two are tied together and what comes between. Here are the key bracketing techniques used in *Microeconomics*:

- Each chapter opens with a set of *learning objectives* posed in the form of issues to be addressed in the chapter. These are then used in question form to organize the *chapter summary*.
- A list of *key terms from previous chapters* appears at the beginning of each chapter. This is balanced by a list of *newly introduced terms* at the end of the chapter.
- Each chapter begins with a *lead-off case* and ends with a *case for discussion*. The first item in the *problems and topics for discussion* at the end of the chapter asks students to apply what they have learned to issues raised in the lead-off case. The case for discussion is followed by its own set of questions. (Answers to these questions are given in the *Instructor’s Manual*.)

Generic Organization of Boxed Cases

Since its first edition, *Microeconomics* has been a leader in the use of case studies as a teaching and learning tool. In addition to the lead-off cases and cases for discussion used to bracket each chapter, numerous *boxed cases* appear within each chapter. An innovative feature of this edition is the organization of these cases into four generic categories, each with a specific purpose:

1. **Economics in the News.** Illustrates an abstract concept raised in the chapter with an actual quoted or paraphrased news item. Example: “Cookie Stores Feel the Bite as Market Shifts” (Chapter 9).
2. **Applying Economic Ideas.** Uses a tool learned in the chapter for solving a problem drawn from real life. Example: “The Opportunity Cost of a College Education” (Chapter 1).
3. **Who Said It? Who Did It?** Highlights the contribution of an economist of the past or present to a key idea discussed in the chapter. Example: “Adam Smith on the Invisible Hand” (Chapter 1).
4. **Perspective.** Takes a look at a controversial issue or adds additional detail to a point raised in the chapter. Example: “The Effect of Advertising on Consumer Perceptions” (Chapter 12).

The Package

A complete support package provides instructors and students with everything they need to teach and learn economics.

Test Bank

Written by Louis Amato and Irvin B. Tucker III, both of the University of North Carolina at Charlotte, in collaboration with Edwin G. Dolan, the *Test Bank* includes more than 2,000 items. The authors have fully class-tested each item, guaranteeing a comprehensive, “teacher-friendly” selection. The *Test Bank* contains the following features.

Number and Type of Questions

The *Test Bank* offers over 1,000 multiple-choice and true/false questions. It also contains many graphical questions.

Distribution of Questions by Chapter

- Each chapter has an appropriate number of questions based on its content and length. This varies from 40 questions for the first, introductory chapter to 120 for some of the core concept chapters.
- Some questions appear in alternate forms to permit reuse.
- Questions are arranged in the approximate order of the chapter coverage of each topic.

Categorization and Coding

All questions are coded according to level of difficulty and cognitive learning type. These are E (easy), M (moderate), D (difficult), DF (definition or fact), SA (simple analysis), and CI (complex interpretation). This allows the instructor to select a spectrum of questions for testing both recall learning and concept comprehension.

Graphing Emphasis

Many questions ask students to work directly on graphs. Questions are formatted to follow the “hands-on” sample items in the *Study Guide*.

Recordkeeping Aid

The *Test Bank* contains marginal recordkeeping space for the instructor to personalize it with the date each question is used and the percentage of students who correctly answer each question.

Additional Exam and Essay Problems

The *Instructor’s Manual* contains two exam and essay problems for each chapter with which to supplement tests. Exam and essay problems typically serve as excellent extra-credit test questions for more proficient students. Answers are included.

Computerized Version

The *Computerized Test Bank* (available for the Apple® IIe, IBM® PC, IBM® PC-XT, and mag tape) allows the instructor to create tests tailored to particular

requirements. By using the questions stored on disk, both short quizzes and full-length exams can be quickly and easily constructed.

The *Computerized Test Bank* allows instructors to

- preview questions on the computer screen
- edit publisher-supplied questions and create personalized questions
- select exam questions manually or randomly
- create exam headings and determine the amount of space to be allotted each question
- scramble questions to create multiple versions of the same test
- print exams with answer keys and student answer sheets
- store exams created for future use
- produce partial hard copy of most graphs that appear in the *Test Bank*.

“Sticky-paper” versions of all graphs are also available for placement on the master copy.

Direct Service Hotline

For instructors who have any technical difficulties with the *Computerized Test Bank*, The Dryden Press/TEC offers a direct service number: 516-681-1773, 9 a.m. to 5 p.m. EST.

Instructor's Manual

The *Instructor's Manual* for *Microeconomics* is intended to help new instructors prepare their first principles course and experienced instructors tailor their course to mesh optimally with the text. With these aims in mind, the *Instructor's Manual* includes the following features.

What's Different Here and Why

This section, found at the beginning of each chapter, helps convert the course outline and lecture notes from other texts to *Microeconomics*, fifth edition. Changes from the fourth edition of *Microeconomics* are noted. This section also provides technical information on the theoretical models that underlie the book.

Instructional Objectives

All elements of the *Microeconomics* package—text, *Study Guide*, *Test Bank*, and *Instructor's Manual*—are coordinated by means of specific instructional objectives listed in each chapter of the *Instructor's Manual*. In the text, they are listed for students at the beginning of each chapter. Questions covering every topic on the list of instructional objectives are included in the *Test Bank*.

EconoGraph II

An important element of the *Microeconomics* package is *EconoGraph II*, a computer-aided instruction program featuring interactive graphical exercises and simulations. It consists of nine computer-based lessons divided between micro- and macroeconomic topics. A special section in the corresponding chapters of the *Instructor's Manual* discusses the use of *EconoGraph II*.

Lecture Notes and Suggestions

Each chapter of the *Instructor's Manual* contains a section of lecture notes in outline form. The pages are perforated and three-hole punched to facilitate their integration with the instructor's own lecture notes. The lecture notes cover the optional appendixes as well as the chapters. In addition, they list transparency acetates that are available for use with the text. The use of the transparencies is more fully discussed in a separate transparency guide.

Examination Problems and Essays

Each chapter contains two or three suggestions for examination problems and essays. These are valuable supplements to the multiple-choice and true/false questions contained in the *Test Bank* where the teaching situation permits grading of problems and essays.

Answers to Selected Problems and Topics for Discussion

Answers are given to selected items from the "Problems and Topics for Discussion" sections of the text as well as the "Case for Discussion" sections in each chapter. Items that involve library research or ask questions that pertain to students' personal or community situation are omitted.

Course Planning Guide

In addition to these chapter-by-chapter features, the introductory section of the *Instructor's Manual* contains extensive suggestions on course planning to fit a wide variety of course calendars.

Study Guide

The *Study Guide* for *Microeconomics* provides students with hands-on applications and self-testing opportunities. It reinforces the text and prepares students for exams. The *Study Guide* contains the following features.

Where You're Going

All parts of the *Microeconomics* package are tied together by a numbered set of learning objectives for each chapter. These learning objectives, which also appear in the text and the *Instructor's Manual*, are given in the "Where You're Going" section of each chapter of the *Study Guide*. A list of terms introduced in the chapter is also provided.

Walking Tour

The "Walking Tour" section is a narrative summary of the chapter and incorporates questions on key points. Students work through this material, answering the questions as they go along. Answers to the questions are given in the margins.

Hands On

This section contains graphical and numerical exercises that give students hands-on experience in working with the concepts covered in the chapter. It is particularly helpful to students who require extra work in order to master difficult graphical material. Complete solutions, including graphs, are given at the end of the chapter.

Economics in the News

Each of these sections takes the form of a brief news item with questions that relate the item to concepts covered in the chapter. Answers are found at the end of the chapter. These items are particularly valuable in preparing for essay-type exam questions. This feature is the *Study Guide* version of the case study approach used in the text and links economics to the real world.

Self Test

This section consists of 15 multiple-choice questions, which are similar in structure to those in the *Test Bank* and act as a final checkpoint before an exam. Annotated answers to the self-test items are given at the end of the chapter.

Don't Make This Common Mistake

These are special boxes, strategically placed throughout the *Study Guide*, that caution students against certain common mistakes made by successive generations of economics students. All of these mistakes are easy to avoid if the student is alerted to them.

Careers in Economics

A unique feature of the *Study Guide* is the "Careers in Economics" section. This section, written by Keith Evans of California State University, Northridge, has been updated for the fifth edition. This material should appeal to students considering a major in economics.

EconoGraph II

Created by Charles Link, Jeffrey Miller, and John Bergman of the University of Delaware, *EconoGraph II* is a computer software package for principles of economics. It consists of nine interactive tutorial lessons. These lessons include the topics students find most difficult to master, including

- supply and demand
- money expansion
- AS/AD
- Keynesian cross analysis
- cost functions
- supply under perfect competition
- monopoly.

EconoGraph II is designed for use with IBM PCs with at least 128K of memory, DOS 2.0, and a color graphics card (use with IBM compatibles is possible but not guaranteed). Features include:

1. Intensive instruction in the use of graphs, which are critical in economics.
2. Self-contained 10- to 40-minute lessons.
3. Diagnostic questions and problems in which the computer tells students what they did right or wrong.
4. Graphical manipulations in which students can plot lines and shift curves.
5. Graphs constructed in stages so that each stage can be explained and important aspects highlighted.
6. Self-paced instruction to allow for repetition and review.

GraphPac

A completely new concept in student study aids, *GraphPac* is the first graph note-taking device available to economics students. Each *GraphPac* tablet contains reproductions of all major graphs in the text with additional graph-ruled margins. *GraphPac* allows students to take notes on key graphs without having to sketch transparency acetates, masters, or basic chalkboard drawings. The marginal graph rules provide space for students to reproduce additional graphs drawn by the instructor during a lecture. This is especially useful when the student wants to capture the effect of a shift or change in a basic graph.

GraphPac is free to students upon adoption of the text. It can be ordered by submitting the request number when placing a textbook order.

GraphPac is unique to the fifth edition of *Microeconomics*.

Transparency Acetates

The transparency acetates are two color and computer generated. This provides maximum accuracy and readability. For complete pedagogical consistency, the color used in the graphics matches that in the text. There are more than 160 acetates of graphs from the text. Each transparency has a complete teaching note to help instructors integrate the transparency into their lectures.

Some Words of Thanks

We wish to thank the following people for their help in revising this edition:

- | | |
|---|--|
| Jack Adams, <i>University of Arkansas</i> | Harish Gupta, <i>University of Nebraska</i> |
| Charles Bennett, <i>Gannon University</i> | James Hamilton, <i>University of Virginia</i> |
| Thomas Bonsor, <i>East Washington University</i> | Oskar Harmon, <i>University of Stamford</i> |
| David Brasfield, <i>Murray State University</i> | Charles Hegji, <i>Auburn University, Montgomery</i> |
| Donald Bumpass, <i>Texas Technical University</i> | John Holland, <i>Iona College</i> |
| William Carlisle, <i>University of Utah</i> | R. James, <i>James Madison University</i> |
| James Clark, <i>Wichita State University</i> | Robert Jerome, <i>James Madison University</i> |
| Avi Cohen, <i>York University</i> | James Jonish, <i>Texas Technical University</i> |
| C. M. Condon, <i>College of Charleston</i> | Ebrahim Karbassioon, <i>Eastern Illinois University</i> |
| James Cover, <i>University of Alabama</i> | Bruce Kaufman, <i>Georgia State University</i> |
| J. R. Cowart, <i>Mobile College</i> | Calvin Kent, <i>Baylor University</i> |
| Kenneth DeHaven, <i>Tri-County Technical College</i> | James Kyle, <i>Indiana State University</i> |
| Mary Deily, <i>Texas A&M University</i> | Luther Lawson, <i>University of North Carolina, Wilmington</i> |
| Howard Elder, <i>University of Alabama</i> | Stephen Lile, <i>Western Kentucky University</i> |
| Charles Ellard, <i>Pan American University</i> | Joseph Lin, <i>Louisiana State University</i> |
| Michael Erickson, <i>Eastern Illinois University</i> | Raymond Lombr, <i>Pennsylvania State University</i> |
| Christopher Fiorentino, <i>West Chester University</i> | Don Losman, <i>National Defense University, Washington</i> |
| David Fractor, <i>California State University, Northridge</i> | J. L. Love, <i>Valdosta State College</i> |
| Gary Galles, <i>Pepperdine University</i> | David MacPherson, <i>Pennsylvania State University</i> |
| Lynne Gillette, <i>Texas A&M University</i> | Jay Marchand, <i>University of Mississippi</i> |
| Robert Gillette, <i>Texas A&M University</i> | Benjamin Matta, <i>New Mexico State University</i> |
| Fred Graham, <i>University of Texas, Arlington</i> | John Mbaku, <i>Kennesaw College</i> |

Eugene McKibbin, <i>Fullerton College</i>	Donald Schaefer, <i>Washington State University</i>
Shah Mehrabi, <i>Mary Washington College</i>	Bruce Seaman, <i>Georgia State University</i>
Joseph Mesky, <i>East Carolina University</i>	Frank Slesnick, <i>Bellarmino College</i>
Don Meyer, <i>Louisiana Tech University</i>	Phillip Smith, <i>Gainesville Junior College</i>
Steve Meyer, <i>Francis Marion College</i>	Ken Somppi, <i>Auburn University</i>
Jefferson Moore, <i>Louisiana State University</i>	David Spenser, <i>Brigham Young University</i>
J. M. Morgan, <i>College of Charleston</i>	Henry Thomasson, <i>Southeastern Louisiana University</i>
John Murdoch, <i>Northeast Louisiana University</i>	Timothy Tregarthen, <i>University of Colorado, Colorado Springs</i>
Kenneth Nowotny, <i>New Mexico State University</i>	David Tuerck, <i>Suffolk University</i>
James O'Neill, <i>University of Delaware</i>	Arienne Turner, <i>Fullerton College</i>
Pat Papachristou, <i>Christian Brothers College</i>	Steven Ullmann, <i>University of Miami</i>
Carl Pearl, <i>Cypress College</i>	K. T. Varghese, <i>James Madison University</i>
Thomas Peterson, <i>Central Michigan University</i>	Thomas Vernon, <i>Clarion University of Pennsylvania</i>
John Piscotta, <i>Baylor University</i>	Michael Watts, <i>Purdue University</i>
J. M. Pogodzinski, <i>Georgia State University</i>	William Weber, <i>Illinois State University</i>
David Rees, <i>Mesa College</i>	Don Williams, <i>Kent State University</i>
Michael Rendich, <i>Westchester Community College</i>	Eugene Williams, <i>Northwestern State University</i>
D. Rogers, <i>LeMoyne College</i>	Ernie Zampelli, <i>Catholic University of America</i>

In addition, we would like to thank the staff of The Dryden Press for making this edition possible. They are a truly dedicated, tireless group of professionals.

Edwin G. Dolan
Great Falls, Virginia

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December 1987

About the Authors

Edwin G. Dolan grew up in a small town in Oregon. He attended Earlham College and then Indiana University, earning a B.A. degree from Indiana. After staying at Indiana to earn an M.A. in economics, he completed his Ph.D. at Yale University. Dolan spent the next few years teaching economics at the University of Connecticut, Dartmouth College, and the University of Chicago. He has served as a specialist in transportation regulation, both in the antitrust division of the U.S. Department of Justice and at the Interstate Commerce Commission. For the last ten years, he has taught economics at George Mason University.

David E. Lindsey comes from the university town of West Lafayette, Indiana. He received his B.A. from Earlham College and his Ph.D. from the University of Chicago, where he studied under Milton Friedman. Lindsey taught economics for several years at Ohio State University and Macalester College. He began his long-running collaboration with Dolan on their principles text while at Macalester. Since 1974 he has been on the staff of the Board of Governors of the Federal Reserve System, where he now serves as Deputy Director of the Division of Monetary Affairs.

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