ELEVENTH EDITION

economics

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London Boston Burr Ridge, IL Dubuque, IA Madison, WI New York San Francisco St. Louis Bangkok Bogotá Caracas Kuala Lumpur Lisbon Madrid Mexico City Milan Montreal New Delhi Santiago Seoul Singapore Sydney Taipei Toronto

Economics 11th Edition
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ISBN-13 9780077154516
ISBN-10 0077154517

Published by McGraw-Hill Education
Shoppenhangers Road
Maidenhead
Berkshire
SL6 2QL
Telephone: 44 (0) 1628 502 500
Fax: 44 (0) 1628 770 224
Website: www.mcgraw-hill.co.uk

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library
Library of Congress Cataloging in Publication Data
The Library of Congress data for this book has been applied for from the Library of Congress

Executive Editor: Natalie Jacobs
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Text design by Hard Lines
Cover design by Adam Renvoize
Printed and bound in Singapore by Markono

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Dedication

For Honora, Mary and Robin – DB
To my family and to my beloved Vitalba – GV

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Preface

Economics is much too interesting to be left to professional economists. It affects almost everything we do, not merely at work or at the shops but also in the home and the voting booth. It influences how well we look after our planet, the future we leave for our children, the extent to which we can care for the poor and the disadvantaged, and the resources we have for enjoying ourselves.

These issues are discussed daily, in bars and on buses as well as in cabinet meetings and boardrooms. The formal study of economics is exciting because it introduces a toolkit that allows a better understanding of the problems we face. Everyone knows a smoky engine is a bad sign, but sometimes only a trained mechanic can give the right advice on how to fix it.

This book is designed to teach you the toolkit and give you practice in using it. Nobody carries an enormous toolbox very far. Useful toolkits are small enough to be portable but contain enough proven tools to deal with both routine problems and unforeseen circumstances. With practice, you will be surprised at how much light this analysis can shed on daily living. This book is designed to make economics seem as useful as it really is.

How much do economists disagree?

People often complain that economists never agree about anything. This is simply not true. The media, taxi-drivers and politicians love to talk about topics on which there is disagreement; it would be boring TV if all participants in a panel discussion held identical views. But economics is not a subject on which there is always an argument for everything. There are answers to many questions.

We aim to show where economists agree – on what and for what reason – and why they sometimes disagree.

Economics in the twenty-first century

Our aim is to allow students to understand today's economic environment. This requires mastering the theory and practising its application. Just as the theory of genetics or of information technology is slowly progressing, so the theory of economics continues to make progress, sometimes in dramatic and exciting ways. Sometimes this is prompted by theoretical reasoning; sometimes it is a response to a dramatic new event, such as the banking crash and subsequent financial meltdown around the world.

We believe in introducing students immediately to the latest ideas in economics. If these can be conveyed simply, why force students to use older approaches that work less well? Two recent developments in economics underlie much of what we do. One is the role of information, the other is globalization.

How information is transmitted and manipulated is central to many issues concerning incentives and competition, including the recent boom in e-commerce. Ease of information, coupled with lower transport costs, also explains trends towards globalization, and associated reductions in national sovereignty, especially in smaller countries. Modern economics helps us make sense of our changing world, think about where it may go next, and evaluate choices that we currently face.

Changes to the eleventh edition

After 30 years at the top, we wanted to ensure that the book remains as relevant for the next 30 years as it has been in the past. Those familiar with previous editions will continue to recognize the underlying structure and approach, a window on the latest thinking about our evolving world and the way in which economics can make sense of it.

The eleventh edition has again been thoroughly revised, using feedback from a broad range of actual and potential adopters. A lot has changed in the last three years and it is all reflected in the text. Specific changes to the new edition include:

- A more detailed introduction to economic analysis has been added to Chapter 1.
- A revision of the analysis of consumer choice and demand decisions.
- A more detailed analysis of cost minimization.
- An extended analysis of individuals' labour supply and wage discrimination.
- A comprehensive analysis of the financial crash – its causes, consequences and possible policy responses, from fiscal stimulus to quantitative easing.
- Full updates throughout to include 2012/13 data in graphs and tables.
- Over 160 contemporary case studies, activities, concepts etc., over 80 of which are new, and which illustrate key ideas with relevance to the real world.
- Important new pedagogical features, including topical new case studies, boxes on economic concepts and activity applications, and optional maths boxes for the technically-minded.
- More electronic resources for both students and lecturers.

With all this change, the book's structure is a bit different from the last edition. The main changes are listed below:

- In response to user feedback, the previous Chapter 29 has become Chapter 26, making the three open economy chapters contiguous (24–26), and allowing a summing-up in Chapter 27 (business cycles) and 28 (supply-side and long-run growth).

- This edition also contains a discussion of competing schools of macroeconomic thought, allowing students to enrich their perspective on alternative approaches to macroeconomics. Chapter 16 briefly reviews the history of macroeconomic thought and Chapter 27 takes stock of how different schools of thought interpret output fluctuations and deviations from potential output.
- Chapter 28 contains an expanded discussion of the role of supply-side economics.
- Having absorbed open economy macroeconomics into our core discussion, the role of Part Five (on the world economy) is now confined to examination of international trade issues.

Learning by doing

Few people practise for a driving test just by reading a book. Even when you think you understand how to do a hill start, it takes a lot of practice to master the finer points. In the same way, we give you lots of examples and real-world applications not just to emphasize the relevance of economics but also to help you master it for yourself. We start at square one and take you slowly through the tools of theoretical reasoning and how to apply them. We use algebra and equations sparingly, more often than not in separate boxes so they can be skipped or used depending on how technically-minded you are. The best ideas are simple and robust, and can usually be explained quite easily.

How to study

Don't just read about economics, try to do it! It is easy, but mistaken, to read on cruise control, highlighting the odd sentence and gliding through paragraphs we have worked hard to simplify. Active learning needs to be interactive. When the text says 'clearly', ask yourself 'why' it is clear. See if you can construct the diagram before you look at it. As soon as you don't follow something, go back and read it again. Try to think of other examples to which the theory could be applied. The only way to check you really understand things is to test yourself. There are opportunities to do this in the book through activity and review questions, as well as online through Connect Economics.

To assist you in working through this text, we have developed a number of distinctive study and design features. To familiarize yourself with these features, please turn to the Guided Tour on pages xv–xvii.

Supplementary resources

Economics, eleventh edition offers a comprehensive package of resources for the teaching and learning of economics. The resources offered with the new edition have been developed in response to feedback from current users in order to provide lecturers with a variety of teaching resources for class teaching, lectures and assessment. Students are also offered a range of extra materials to assist in learning, revising and applying the principles of economics.

Connect

Connect Economics is a digital teaching and learning environment that improves performance over a variety of critical outcomes. It gives lecturers and tutors the power to create assignments, tests and quizzes online. Easily accessible grade reports allow you to track your students' progress. Students get feedback on each individual question and immediate grading on both assignments and independent revision questions, which makes it the perfect platform to test your knowledge. Videos, animated graphs, case studies and vignettes allow students to explore complicated graphs and concepts in more detail.

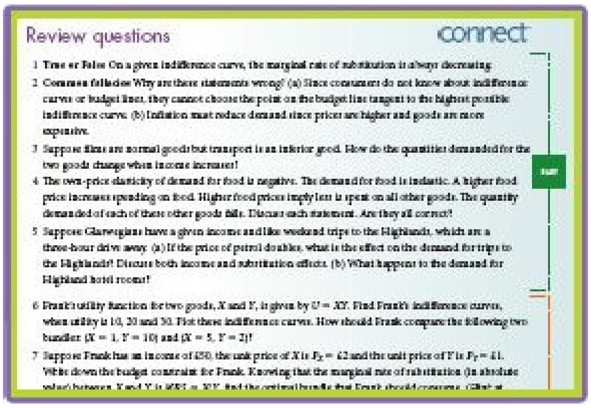
To learn more about Connect, turn to page xxiv or visit **connect.mcgraw-hill.com/economics.**

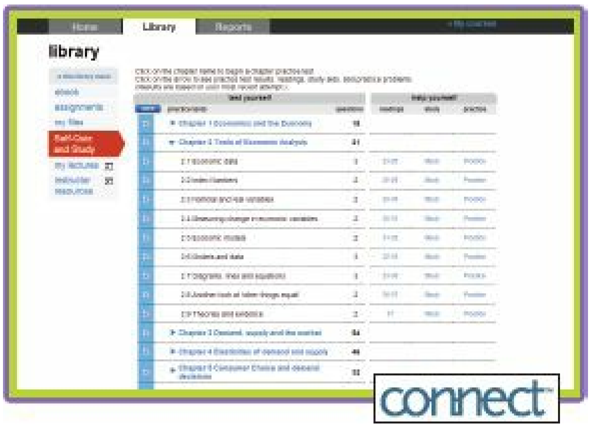
Online Learning Centre

An accompanying Online Learning Centre website has been developed to provide an unrivalled package of flexible, high-quality resources for lecturers. To access all of the free Online Learning Centre resources and to find out about enhanced options, simply visit the website at **www.mcgraw-hill.co.uk/textbooks/begg**.

To learn more about the resources available to lecturers and students online, go to our tour of the resources on page xxiii.

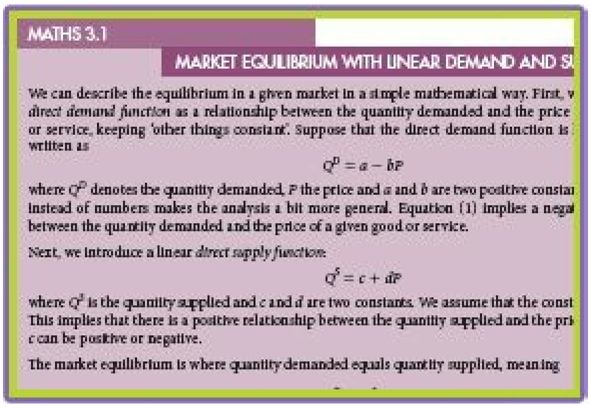
Guided tour

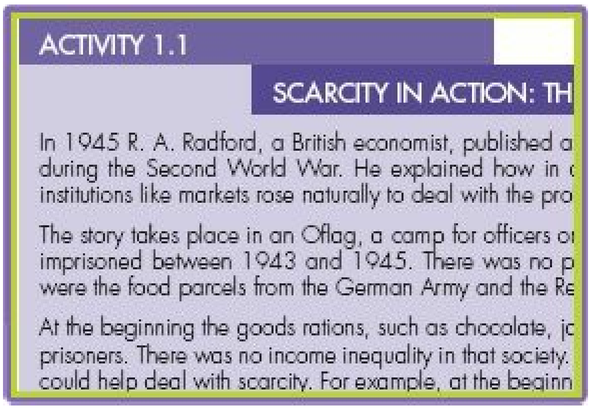


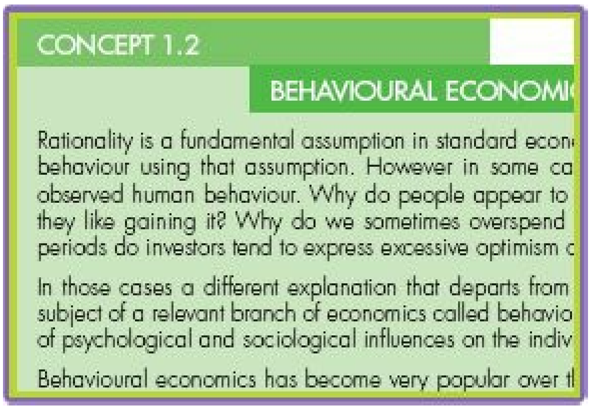


PRACTICE AND TESTING

Review questions encourage you to apply the knowledge you have acquired from each chapter. The questions are graded by difficulty, allowing you to stretch yourself further once you have mastered the topic at a basic level. These questions are all integrated into Connect, through which your lecturer can set homework assignments. The Self-Quiz and Study side of Connect provides questions to assess your knowledge and then recommends specific readings, revision tools and additional practice work.

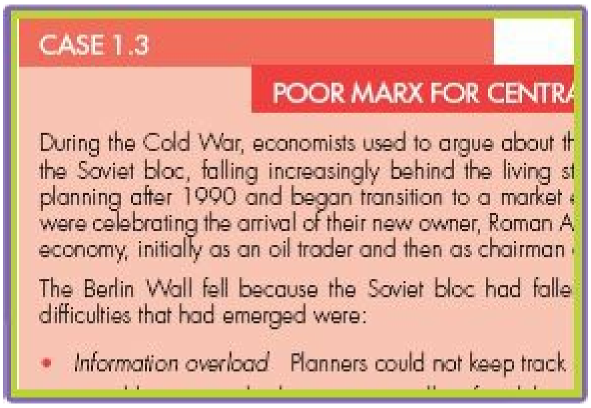






APPLICATION

Each chapter includes a number of boxed examples. These aim to show how a particular economic example can be applied in practice. They are explained in further detail on pages xviii–xxii. Connect also provides helpful tools to relate what is learnt in the book to real life, including additional case studies, a range of videos and animated graphs.



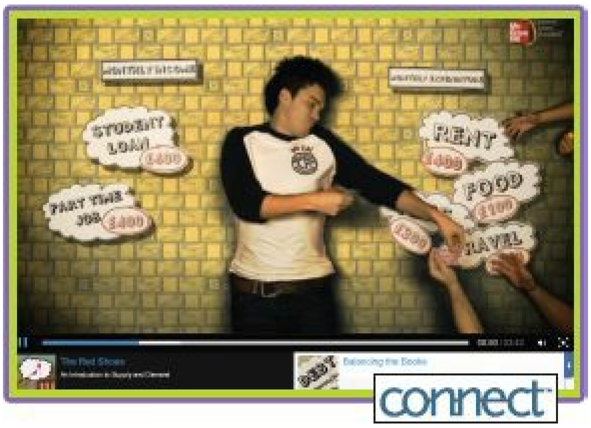
CASE 1.3

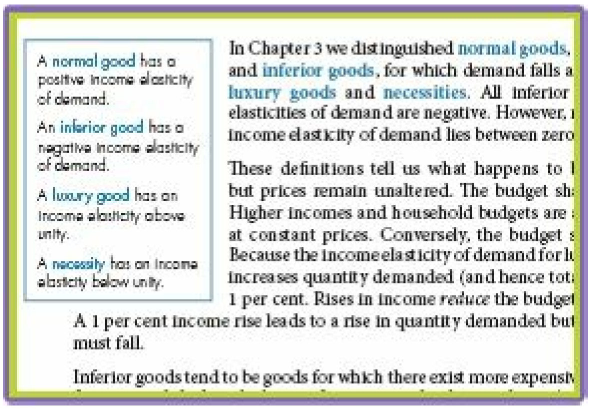
POOR MARX FOR CENTRA

During the Cold War, economists used to argue about th
the Soviet bloc, falling increasingly behind the living st
planning after 1990 and began transition to a market e
were celebrating the arrival of their new owner, Roman A
economy, initially as an oil trader and then as chairman

The Berlin Wall fell because the Soviet bloc had falle
difficulties that had emerged were:

- *Information overload* Planners could not keep track





A normal good has a positive income elasticity of demand.

An inferior good has a negative income elasticity of demand.

A luxury good has an income elasticity above unity.

A necessity has an income elasticity below unity.

In Chapter 3 we distinguished normal goods,
and inferior goods, for which demand falls a
luxury goods and necessities. All inferior
elasticities of demand are negative. However, i
income elasticity of demand lies between zero

These definitions tell us what happens to t
but prices remain unaltered. The budget sh
Higher incomes and household budgets are
at constant prices. Conversely, the budget s
Because the income elasticity of demand for lu
increases quantity demanded (and hence tot
1 per cent. Rises in income *reduce* the budget

A 1 per cent income rise leads to a rise in quantity demanded but
must fall.

Inferior goods tend to be goods for which there exist more expensi

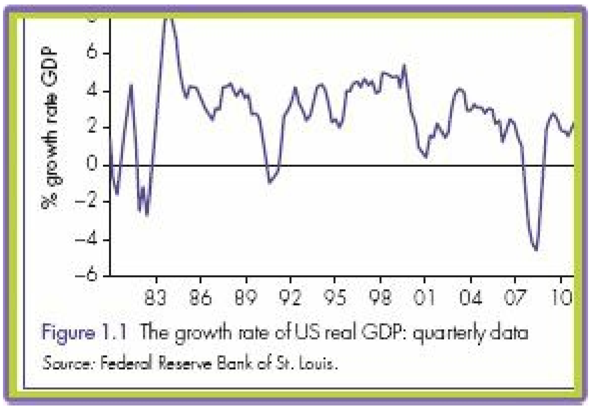
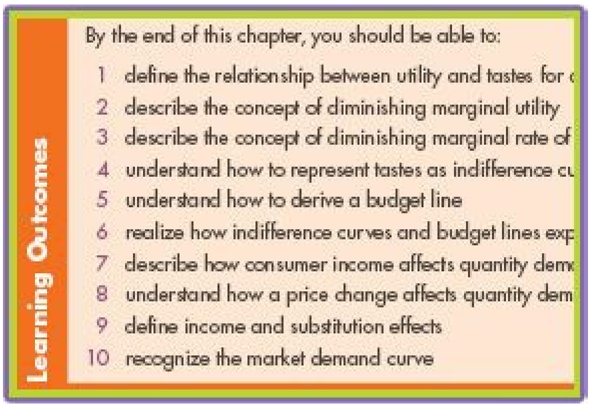


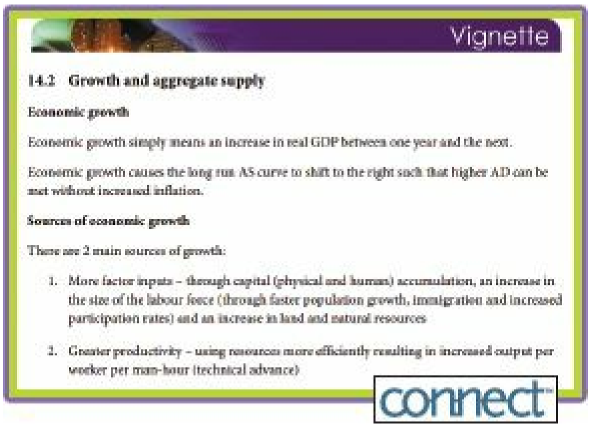
Figure 1.1 The growth rate of US real GDP: quarterly data

Source: Federal Reserve Bank of St. Louis.

AIDING UNDERSTANDING

Each chapter offers extensive pedagogy to aid your understanding of the topics. This includes Learning Outcomes, Key Terms, Summaries and extensive tables and figures. Further tools, such as summaries and videos, are available in Connect.


Learning Outcomes
By the end of this chapter, you should be able to:
1 define the relationship between utility and tastes for
2 describe the concept of diminishing marginal utility
3 describe the concept of diminishing marginal rate of
4 understand how to represent tastes as indifference cu
5 understand how to derive a budget line
6 realize how indifference curves and budget lines exp
7 describe how consumer income affects quantity dem
8 understand how a price change affects quantity dem
9 define income and substitution effects
10 recognize the market demand curve


Vignette
14.2 Growth and aggregate supply
Economic growth
Economic growth simply means an increase in real GDP between one year and the next.
Economic growth causes the long run AS curve to shift to the right such that higher AD can be met without increased inflation.
Sources of economic growth
There are 2 main sources of growth:
1. More factor inputs – through capital (physical and human) accumulation, an increase in the size of the labour force (through faster population growth, immigration and increased participation rates) and an increase in land and natural resources
2. Greater productivity – using resources more efficiently resulting in increased output per worker per man-hour (technical advance)
connect

Boxed material

The text offers a wealth of boxed material to help explain how a particular economic principle can be applied in practice. There are four different types of box:

- **Case:** These draw on real-life companies and topical events to help illustrate economics in action.
- **Concept:** These contain content that is slightly more complex and provide some additional, more challenging, topics for you to explore.
- **Activity:** Similar to those in the last edition, these illustrate key economic concepts and then ask you to apply them to the real world. There are questions at the end of each activity and you can find the answers at the back of the book.
- **Maths:** These boxes highlight key mathematical formulae and present them in a digestible format. They can easily be skipped without interrupting the flow of the chapter, if necessary.