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THIRTEENTH EDITION

Karl E. Case • Ray C. Fair • Sharon M. Oster



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Homework: Chapter 5

Concept: Market; Demand; Private Good

Price	Quantity Demanded	Quantity Supplied
10	4	1
8	10	3
6	15	10
4	20	15
2	25	20

Market Equilibrium

Price

Quantity Demanded

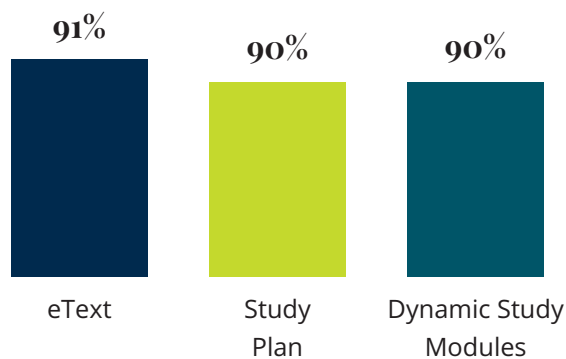
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Principles of **Economics**

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This edition is dedicated to Chip Case, a wonderful colleague and friend. He was the inspiration for this textbook some 30 years ago, and he served as an inspiration to study economics for thousands of students.

About the Authors



Karl E. Case, who passed away in July, 2016, was a Professor of Economics Emeritus at Wellesley College where he taught for 34 years, serving several tours of duty as Department Chair. He was a Senior Fellow at the Joint Center for Housing Studies at Harvard University and a founding partner in the real estate research firm of Fiserv Case Shiller Weiss, which produces the S&P Case-Shiller Index of home prices. He served as a member of the Index Advisory Committee of Standard and Poor's, and on the Academic Advisory Board of the Federal Reserve Bank of Boston.

Professor Case received his B.A. from Miami University in 1968, spent three years on active duty in the Army, and received his Ph.D. in Economics from Harvard University in 1976.

Professor Case's research was in the areas of real estate, housing, and public finance. He authored or coauthored five books, including *Principles of Economics*, *Economics and Tax Policy*, and *Property Taxation: The Need for Reform*, and published numerous articles in professional journals, focused on real estate markets and prices.

Chip, as he was known to his many friends and colleagues, contributed to this textbook throughout its many editions. In his honor and with respect for his substantial contributions to the text and the discipline of economics, his co-authors plan to keep his name on the text for all future editions.



Ray C. Fair is Professor of Economics at Yale University. He is a member of the Cowles Foundation at Yale and a Fellow of the Econometric Society. He received a B.A. in Economics from Fresno State College in 1964 and a Ph.D. in Economics from MIT in 1968. He taught at Princeton University from 1968 to 1974. Professor Fair has taught introductory and intermediate macroeconomics at Yale since 1974. He has also taught graduate courses in macroeconomic theory and macroeconometrics.

Professor Fair's research has primarily been in the areas of macroeconomics and econometrics, with particular emphasis on macroeconomic model building. He has also done work in the areas of finance, voting behavior, and aging in sports. His publications include *Specification, Estimation, and Analysis of Macroeconometric Models* (Harvard Press, 1984); *Testing Macroeconometric Models* (Harvard Press, 1994); *Estimating How the Macroeconomy Works* (Harvard Press, 2004), and *Predicting Presidential Elections and Other Things* (Stanford University Press, 2012).

Professor Fair's U.S. and multicountry models are available for use on the Internet free of charge. The address is <http://fairmodel.econ.yale.edu>. Many teachers have found that having students work with the U.S. model on the Internet is a useful complement to an introductory macroeconomics course.



Sharon M. Oster is the Frederic Wolfe Professor of Economics and Management and former Dean of the Yale School of Management. Professor Oster joined Case and Fair as a coauthor in the ninth edition of this book. Professor Oster has a B.A. in Economics from Hofstra University and a Ph.D. in Economics from Harvard University.

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Brief Contents

PART I Introduction to Economics 33

- 1 The Scope and Method of Economics 33
- 2 The Economic Problem: Scarcity and Choice 55
- 3 Demand, Supply, and Market Equilibrium 75
- 4 Demand and Supply Applications 106
- 5 Elasticity 124

PART II The Market System 145

- 6 Household Behavior and Consumer Choice 148
- 7 The Production Process: The Behavior of Profit-Maximizing Firms 177
- 8 Short-Run Costs and Output Decisions 200
- 9 Long-Run Costs and Output Decisions 220
- 10 Input Demand: The Labor and Land Markets 244
- 11 Input Demand: The Capital Market and the Investment Decision 260
- 12 General Equilibrium and the Efficiency of Perfect Competition 281

PART III Market Imperfections and the Role of Government 296

- 13 Monopoly and Antitrust Policy 296
- 14 Oligopoly 321
- 15 Monopolistic Competition 344
- 16 Externalities, Public Goods, and Common Resources 359
- 17 Uncertainty and Asymmetric Information 382
- 18 Income Distribution and Poverty 398
- 19 Public Finance: The Economics of Taxation 422

PART IV Concepts and Problems in Macroeconomics 444

- 20 Introduction to Macroeconomics 444
- 21 Measuring National Output and National Income 457

- 22 Unemployment, Inflation, and Long-Run Growth 477

PART V The Core of Macroeconomic Theory 493

- 23 Aggregate Expenditure and Equilibrium Output 495
- 24 The Government and Fiscal Policy 516
- 25 Money, the Federal Reserve, and the Interest Rate 542
- 26 The Determination of Aggregate Output, the Price Level, and the Interest Rate 569
- 27 Policy Effects and Cost Shocks in the AS/AD Model 586
- 28 The Labor Market in the Macroeconomy 599

PART VI Further Macroeconomics Issues 618

- 29 Financial Crises, Stabilization, and Deficits 618
- 30 Household and Firm Behavior in the Macroeconomy: A Further Look 634
- 31 Long-Run Growth 655
- 32 Alternative Views in Macroeconomics 671

PART VII The World Economy 687

- 33 International Trade, Comparative Advantage, and Protectionism 687
- 34 Open-Economy Macroeconomics: The Balance of Payments and Exchange Rates 711
- 35 Economic Growth in Developing Economies 737

PART VIII Methodology 754

- 36 Critical Thinking about Research 754
- Glossary 769**
- Index 784**
- Credits 811**

Contents

PART I Introduction to Economics 33

1 The Scope and Method of Economics 33

Why Study Economics? 34

To Learn a Way of Thinking 34

ECONOMICS IN PRACTICE Rainfall and Schooling in India 35

ECONOMICS IN PRACTICE Majoring in Economics Makes You Less Vulnerable to a Recession! 36

To Understand Society 36

To Be an Informed Citizen 37

The Scope of Economics 37

Microeconomics and Macroeconomics 37

ECONOMICS IN PRACTICE How Italian Is a Ferrari? 38

The Diverse Fields of Economics 39

The Method of Economics 40

Theories and Models 40

ECONOMICS IN PRACTICE Does Your Part-time Job Affect Your Academic Performance? 42

Economic Policy 42

An Invitation 44

Economic Skills and Economics as a Career 44

Summary 44 Review Terms and Concepts 45

Problems 45 Appendix: How to Read and Understand Graphs 47

2 The Economic Problem: Scarcity and Choice 55

Scarcity, Choice, and Opportunity Cost 56

Scarcity and Choice in a One-Person Economy 56

Scarcity and Choice in an Economy of Two or More 57

ECONOMICS IN PRACTICE Frozen Foods and Opportunity Costs 58

The Production Possibility Frontier 61

The Economic Problem 67

ECONOMICS IN PRACTICE Changing Consumption Patterns in China 68

Economic Systems and the Role of Government 68

Command Economies 68

Laissez-Faire Economies: The Free Market 69

Mixed Systems, Markets, and Governments 70

Looking Ahead 70

Summary 70 Review Terms and Concepts 71 Problems 71

3 Demand, Supply, and Market Equilibrium 75

Firms and Households: The Basic

Decision-Making Units 76

Input Markets and Output Markets: The Circular Flow 76

Demand in Product/Output Markets 78

Changes in Quantity Demanded versus Changes in Demand 78

Price and Quantity Demanded: The Law of Demand 79

Other Determinants of Household Demand 82

ECONOMICS IN PRACTICE Have You Bought This Textbook? 83

ECONOMICS IN PRACTICE People Drink Tea on Rainy Days 84

Shift of Demand versus Movement along

a Demand Curve 85

From Household Demand to Market Demand 86

Supply in Product/Output Markets 88

Price and Quantity Supplied: The Law of Supply 89

Other Determinants of Supply 90

Shift of Supply versus Movement along a Supply Curve 91

From Individual Supply to Market Supply 92

Market Equilibrium 93

Excess Demand 93

Excess Supply 95

Market Equilibrium with Equations 96

Changes in Equilibrium 96

ECONOMICS IN PRACTICE Quinoa 99

Demand and Supply in Product Markets: A Review 99

ECONOMICS IN PRACTICE “Shrinkflation” During Festive Seasons 100

Looking Ahead: Markets and the Allocation of Resources 101

Summary 101 Review Terms and Concepts 102 Problems 103

4 Demand and Supply Applications 106

The Price System: Rationing and Allocating Resources 107

Price Rationing 107

Constraints on the Market and Alternative Rationing Mechanisms 109

ECONOMICS IN PRACTICE Why Do I Have to Pay More for My Food? The Truth behind the Flood Crises 111

Prices and the Allocation of Resources 113

Price Floor 113

Supply and Demand Analysis: Tariffs (Tax) 114

ECONOMICS IN PRACTICE The Price Mechanism at Work for Shakespeare 115

Supply and Demand and Market Efficiency 116

Consumer Surplus 116

Producer Surplus 117

Competitive Markets Maximize the Sum of Producer and Consumer Surplus 118

Potential Causes of Deadweight Loss From Under- and Overproduction 119

Looking Ahead 120

Summary 120 Review Terms and Concepts 120 Problems 121

5 Elasticity 124

Price Elasticity of Demand 125

Slope and Elasticity 125

Types of Elasticity 126

Calculating Elasticities 127

Calculating Percentage Changes 127

Elasticity Is a Ratio of Percentages 128

The Midpoint Formula 128

Elasticity Changes along a Straight-Line Demand Curve 129

Elasticity and Total Revenue 132

The Determinants of Demand Elasticity 133

Availability of Substitutes 133

The Importance of Being Unimportant 133

Luxuries versus Necessities 133

ECONOMICS IN PRACTICE Elasticities at a Delicatessen in the Short Run and Long Run 134

The Time Dimension 134

Other Important Elasticities 135

Income Elasticity of Demand 135

Cross-Price Elasticity of Demand 135

Elasticity of Supply 136

ECONOMICS IN PRACTICE Brexit and EU Student Enrolment in the United Kingdom 137

What Happens when We Raise Taxes: Using Elasticity 137

Looking Ahead 139

Summary 139 Review Terms and Concepts 140 Problems 140

PART II The Market System 145

6 Household Behavior and Consumer Choice 148

Household Choice in Output Markets 149

The Determinants of Household Demand 149

The Budget Constraint 149

The Equation of the Budget Constraint 152

The Basis of Choice: Utility 153

Diminishing Marginal Utility 153

Allocating Income to Maximize Utility 154

The Utility-Maximizing Rule 156

ECONOMICS IN PRACTICE Sugar Tax in Chile 157

Diminishing Marginal Utility and

Downward-Sloping Demand 157

Income and Substitution Effects 158

The Income Effect 158

The Substitution Effect 159

Household Choice in Input Markets 160

The Labor Supply Decision 160

ECONOMICS IN PRACTICE Substitution and Market Baskets 161

The Price of Leisure 161

Income and Substitution Effects of a Wage Change 162

ECONOMICS IN PRACTICE Part-Time Employment for Students 163

Saving and Borrowing: Present versus Future Consumption 164

A Review: Households in Output and Input Markets 165

Summary 165 Review Terms and Concepts 166

Problems 166 Appendix: Indifference Curves 170

7 The Production Process: The Behavior of Profit-Maximizing Firms 177

The Behavior of Profit-Maximizing Firms 178

Profits and Economic Costs 179

Short-Run versus Long-Run Decisions 180

The Bases of Decisions: Market Price of Outputs, Available Technology, and Input Prices 181

The Production Process 182

Production Functions: Total Product, Marginal Product, and Average Product 182

Production Functions with Two Variable Factors of Production 185

ECONOMICS IN PRACTICE Gains from Modern Management 186

Choice of Technology 186

ECONOMICS IN PRACTICE How Soon Should Preventive Maintenance Be Employed? 187

Looking Ahead: Cost and Supply 188

Summary 188 Review Terms and Concepts 189

Problems 189 Appendix: Isoquants and Isocosts 193

8 Short-Run Costs and Output Decisions 200

Costs in the Short Run 201

Fixed Costs 201

Variable Costs 203

ECONOMICS IN PRACTICE How Much Do *Phantom* Tickets Cost Their Producers? 208

Total Costs 208

Short-Run Costs: A Review 210

Output Decisions: Revenues, Costs, and Profit Maximization 211

Perfect Competition 211

Total Revenue and Marginal Revenue 212

Comparing Costs and Revenues to Maximize Profit 212

The Short-Run Supply Curve 214

Looking Ahead 215

Summary 216 Review Terms and Concepts 217 Problems 217

9 Long-Run Costs and Output Decisions 220

Short-Run Conditions and Long-Run Directions 221

Maximizing Profits 221

Minimizing Losses 224

The Short-Run Industry Supply Curve 224

Long-Run Directions: A Review 226

Long-Run Costs: Economies and Diseconomies of Scale 226

Increasing Returns to Scale 227

ECONOMICS IN PRACTICE Economies of Scale in Mobile Services 228

Constant Returns to Scale 228

Diseconomies of Scale 229

ECONOMICS IN PRACTICE Diseconomies of Scale in Secondary School Education 229

U-Shaped Long-Run Average Costs 230

ECONOMICS IN PRACTICE The Long-Run Average Cost Curve: Flat or U-Shaped? 230

Long-Run Adjustments to Short-Run Conditions 231

Short-Run Profits: Moves In and Out of Equilibrium 231

The Long-Run Adjustment Mechanism: Investment Flows Toward Profit Opportunities 233

Output Markets: A Final Word 234

ECONOMICS IN PRACTICE Why is Food so Expensive at an Airport? 235

Summary 235 Review Terms and Concepts 236 Problems 236

Appendix: External Economies and Diseconomies 240

10 Input Demand: The Labor and Land Markets 244

Input Markets: Basic Concepts 245

Demand for Inputs: A *Derived Demand* 245

Marginal Revenue Product 245

ECONOMICS IN PRACTICE MBA or Not for the Greek Youth? 246

ECONOMICS IN PRACTICE How Much is Flexibility Worth? 248

Labor Supply 248

Labor Markets 249

The Firm's Labor Market Decision 249

ECONOMICS IN PRACTICE What Does Your Favorite La Liga Player Make? 250

Many Labor Markets 251

Land Markets 251

Rent and the Value of Output Produced on Land 252

ECONOMICS IN PRACTICE Land Valuation 253

Input Demand Curves 253

Shifts in Factor Demand Curves 253

Profit-maximizing Condition in Input Markets 255

Looking Ahead 255

Summary 256 Review Terms and Concepts 256 Problems 257

11 Input Demand: The Capital Market and the Investment Decision 260

Capital and Investment 261

Capital 261

The Demand for New Capital and the Investment Decision 262

Forming Expectations 263

Comparing Costs and Expected Returns 264

The Capital Market 266

ECONOMICS IN PRACTICE Saudi Arabia's Vision 2030 267

Capital Income: Interest and Profits 268

Financial Markets in Action 269

ECONOMICS IN PRACTICE The Stock Market 270

ECONOMICS IN PRACTICE Do Children Learn or Inherit Investing Strategies from Their Parents? 271

Capital Accumulation and Allocation 271

A Final Word on Capital 271

Summary 272 Review Terms and Concepts 273

Problems 273 Appendix: Calculating Present Value 275

12 General Equilibrium and the Efficiency of Perfect Competition 281

Market Adjustment to Changes in Demand 282

Allocative Efficiency and Competitive Equilibrium 284

Pareto Efficiency 284

ECONOMICS IN PRACTICE Cutting Rice Cultivation and Water Rationing in Egypt 285

The Efficiency of Perfect Competition 286

Perfect Competition versus Real Markets 289

The Sources of Market Failure 290

Imperfect Competition 290

Public Goods 290

Externalities 291

Imperfect Information 291

Evaluating the Market Mechanism 292

Summary 292 Review Terms and Concepts 293 Problems 293

PART III Market Imperfections and the Role of Government 296

13 Monopoly and Antitrust Policy 296

Imperfect Competition and Market Power: Core Concepts 297

Forms of Imperfect Competition and Market Boundaries 297

Price and Output Decisions in Pure Monopoly Markets 298

Demand in Monopoly Markets 298

ECONOMICS IN PRACTICE Figuring Out the Right Price 299

Perfect Competition and Monopoly Compared 304

Monopoly in the Long Run: Barriers to Entry 305

ECONOMICS IN PRACTICE Is Being a Monopolist Always Good? 306

The Social Costs of Monopoly 308

Inefficiency and Consumer Loss 308

Rent-Seeking Behavior 310

Price Discrimination 311

Examples of Price Discrimination 312

ECONOMICS IN PRACTICE Price Discrimination at Work: The Uffizi Gallery 313

Remedies for Monopoly: Antitrust Policy 314

Major Antitrust Legislation 314

ECONOMICS IN PRACTICE What Tesla Does with Near-Monopoly Power 315

Imperfect Markets: A Review and a Look Ahead 316

Summary 316 Review Terms and Concepts 317

Problems 318

14 Oligopoly 321

Market Structure in an Oligopoly 322

ECONOMICS IN PRACTICE Patents in the Smartphone Industry 324

Oligopoly Models 325

The Collusion Model 325

The Price-Leadership Model 326

ECONOMICS IN PRACTICE The Philippines' Rice Cartel 326

The Cournot Model 327

ECONOMICS IN PRACTICE The Economics of Treating Cancer 329

Game Theory 330

Repeated Games 332

ECONOMICS IN PRACTICE Confusing Prices 334

A Game with Many Players: Collective Action Can Be Blocked by a Prisoner's Dilemma 334

Oligopoly and Economic Performance 335

Industrial Concentration and Technological Change 336

The Role of Government 337

Regulation of Mergers 337

ECONOMICS IN PRACTICE Brazil's Pulp Giant 338

A Proper Role for Government? 339

Summary 340 Review Terms and Concepts 341 Problems 341

15 Monopolistic Competition 344

Industry Characteristics 345

Product Differentiation and Advertising 346

How Many Varieties? 346

How Do Firms Differentiate Products? 347

ECONOMICS IN PRACTICE Rational Excess Variety or Diversification Bias? 348**ECONOMICS IN PRACTICE** Even Your Hair Needs Coaching 350

Advertising 350

ECONOMICS IN PRACTICE Oprah Winfrey's Celebrity Endorsements Sell Books! 352**Price and Output Determination in Monopolistic Competition 353**

Product Differentiation and Demand Elasticity 353

Price/Output Determination in the Short Run 353

Price/Output Determination in the Long Run 354

Economic Efficiency and Resource Allocation 355

Summary 356 Review Terms and Concepts 357 Problems 357

16 Externalities, Public Goods, and Common Resources 359**Externalities and Environmental Economics 360**

Marginal Social Cost and Marginal Cost Pricing 360

ECONOMICS IN PRACTICE Adjusting to the Environmental Effects of Globalization 362

Costs and Benefits of Pollution 363

Internalizing Externalities 365

ECONOMICS IN PRACTICE The Cost of Emissions 370**ECONOMICS IN PRACTICE** Emissions and Electricity Prices 372**Public (Social) Goods 373**

The Characteristics of Public Goods 373

Public Provision of Public Goods 374

Optimal Provision of Public Goods 374

Local Provision of Public Goods: Tiebout Hypothesis 377

Common Resources 377

Summary 378 Review Terms and Concepts 378 Problems 379

17 Uncertainty and Asymmetric Information 382**Decision Making Under Uncertainty: The Tools 383**

Expected Value 383

Expected Utility 383

Attitudes Toward Risk 385

Asymmetric Information 387

Adverse Selection 387

ECONOMICS IN PRACTICE Adverse Selection in the Healthcare Market 389

Market Signaling 390

ECONOMICS IN PRACTICE The Health Care Mandate 391**ECONOMICS IN PRACTICE** How to Read Advertisements 392

Moral Hazard 393

Incentives 393**ECONOMICS IN PRACTICE** Independent Reviews and Wanderlust 394

Labor Market Incentives 394

Summary 395 Review Terms and Concepts 396 Problems 396

18 Income Distribution and Poverty 398**The Sources of Household Income 399**

Wages and Salaries 399

Income from Property 399

Income from the Government: Transfer Payments 399

The Distribution of Market Income 399

Income Inequality in the United States 399

Causes of Inequality in Market Income 401

Inequality in Wage Income 402

ECONOMICS IN PRACTICE Inclusive Growth in South Africa 403**ECONOMICS IN PRACTICE** Social Identity and Tech Jobs 404

Inequality in Property Income 405

ECONOMICS IN PRACTICE The Egyptian Revolution of Dignity 406**Arguments for and Against Reducing Market-Income Inequality 407**

Arguments Against Redistribution 407

Arguments in Favor of Redistribution 408

Redistribution of Income Through Taxes and Transfers	409
The Tax System	410
The Transfer System	411
Redistribution Effects of Taxes and Transfers in 2013	413
Change in U.S. Inequality Over Time: 1979–2013	413
Poverty	414
The Minimum Wage	415
The Distribution of Wealth	416
Income Inequality in Other Countries	416
Government or the Market? A Review	417
Summary	418
Review Terms and Concepts	419
Problems	419

19 Public Finance: The Economics of Taxation 422

The Basics of Taxation	423
Taxes: Basic Concepts	423

ECONOMICS IN PRACTICE Residential Property Taxes in Singapore	425
--	-----

Tax Incidence: Who Pays?	426
--------------------------	-----

The Incidence of Payroll Taxes	426
The Incidence of Corporate Profits Taxes	429

ECONOMICS IN PRACTICE Economists Argue About the Incidence of the Corporate Profits Tax	431
--	-----

The Overall Incidence of Taxes in the United States: Empirical Evidence	431
---	-----

Excess Burdens and the Principle of Neutrality	431
--	-----

Measuring Excess Burdens	432
Excess Burdens and the Degree of Distortion	433

The Principle of Second Best	434
------------------------------	-----

Optimal Taxation	434
------------------	-----

Tax Equity	434
------------	-----

What Is the “Best” Tax Base?	435
------------------------------	-----

Social Choice	437
---------------	-----

The Voting Paradox	437
Government Inefficiency: Theory of Public Choice	439
Rent-Seeking Revisited	440

Summary	440
Review Terms and Concepts	441
Problems	441

PART IV Concepts and Problems in Macroeconomics 444

20 Introduction to Macroeconomics 444

Macroeconomic Concerns	445
Output Growth	445

Unemployment	447
--------------	-----

Inflation and Deflation	447
-------------------------	-----

The Components of the Macroeconomy	448
------------------------------------	-----

The Circular Flow Diagram	448
---------------------------	-----

The Three Market Arenas	449
-------------------------	-----

The Role of the Government in the Macroeconomy	450
--	-----

A Brief History of Macroeconomics	451
-----------------------------------	-----

ECONOMICS IN PRACTICE Macroeconomics in Literature	452
---	-----

The U.S. Economy Since 1970	453
-----------------------------	-----

Summary	455
Review Terms and Concepts	455
Problems	455

21 Measuring National Output and National Income 457

Gross Domestic Product	458
------------------------	-----

Final Goods and Services	458
--------------------------	-----

Exclusion of Used Goods and Paper Transactions	459
--	-----

Exclusion of Output Produced Abroad by Domestically Owned Factors of Production	459
---	-----

Calculating GDP	460
-----------------	-----

The Expenditure Approach	460
--------------------------	-----

ECONOMICS IN PRACTICE Are Christie’s Brokerage Services Counted in GDP?	461
--	-----

ECONOMICS IN PRACTICE Estimating Depreciation in the National Income and Product Accounts	463
--	-----

The Income Approach	464
---------------------	-----

Nominal Versus Real GDP	466
-------------------------	-----

ECONOMICS IN PRACTICE GDP: One of the Great Inventions of the 20th Century	467
---	-----

Calculating Real GDP	468
----------------------	-----

Calculating the GDP Deflator	469
------------------------------	-----

The Problems of Fixed Weights	470
-------------------------------	-----

Limitations of the GDP Concept	470
--------------------------------	-----

GDP and Social Welfare	470
------------------------	-----

The Informal Economy	471
----------------------	-----

ECONOMICS IN PRACTICE An Alternative to GDP: The Human Development Index	471
---	-----

Gross National Income per Capita	472
----------------------------------	-----

Looking Ahead	473
---------------	-----

Summary	473
Review Terms and Concepts	474
Problems	474

22 Unemployment, Inflation, and Long-Run Growth 477

Unemployment	478
--------------	-----

Measuring Unemployment	478
------------------------	-----

ECONOMICS IN PRACTICE Time Use for the Unemployed in a Recession	479
---	-----

Components of the Unemployment Rate 480

ECONOMICS IN PRACTICE Female Labor Force Participation and Economic Development 481

The Costs of Unemployment 481

ECONOMICS IN PRACTICE The Consequences of Unemployment Persist 482

Inflation and Deflation 483

The Consumer Price Index 483

The Costs of Inflation 485

What about Deflation? 487

ECONOMICS IN PRACTICE Chain-Linked Consumer Price Index in the News 487

Long-run Growth 488

Output and Productivity Growth 488

Looking Ahead 490

Summary 490 Review Terms and Concepts 490 Problems 491

PART V The Core of Macroeconomic Theory 493

23 Aggregate Expenditure and Equilibrium Output 495

The Keynesian Theory of Consumption 496

ECONOMICS IN PRACTICE Behavioral Biases in Saving Behavior 500

Other Determinants of Consumption 500

Planned Investment (I) versus Actual Investment 501

Planned Investment and the Interest Rate (r) 501

Other Determinants of Planned Investment 502

The Determination of Equilibrium Output (Income) 502

The Saving/Investment Approach to Equilibrium 505

Adjustment to Equilibrium 506

The Multiplier 506

ECONOMICS IN PRACTICE The Rise and Fall of Nokia 507

The Multiplier Equation 509

ECONOMICS IN PRACTICE The Paradox of Thrift 510

The Size of the Multiplier in the Real World 511

Looking Ahead 511

Summary 512 Review Terms and Concepts 512 Problems 512 Appendix 515

24 The Government and Fiscal Policy 516

Government in the Economy 517

Government Purchases (G), Net Taxes (T), and Disposable Income (Y_d) 517

The Determination of Equilibrium Output (Income) 519

Fiscal Policy at Work: Multiplier Effects 521

The Government Spending Multiplier 521

The Tax Multiplier 524

The Balanced-Budget Multiplier 525

The Federal Budget 527

The Budget in 2017 527

Fiscal Policy since 1993: The Clinton, Bush, Obama, and Trump Administrations 528

ECONOMICS IN PRACTICE Regional Autonomy and Government Budgeting in Spain 530

The Federal Government Debt 531

The Economy's Influence on the Government Budget 532

Automatic Stabilizers and Destabilizers 532

Full-Employment Budget 533

Looking Ahead 533

Summary 533 Review Terms and Concepts 534

Problems 534 Appendix A 537 Appendix B 538

Appendix Summary 541 Appendix Problems 541

25 Money, the Federal Reserve, and the Interest Rate 542

An Overview of Money 543

What Is Money? 543

ECONOMICS IN PRACTICE Don't Kill the Birds! 544

Commodity and Fiat Monies 544

Measuring the Supply of Money in the United States 545

How Banks Create Money 547

A Historical Perspective: Goldsmiths 547

ECONOMICS IN PRACTICE A Run on the Bank: George Bailey, Mary Poppins, Wyatt Earp 548

The Modern Banking System 549

The Creation of Money 550

The Money Multiplier 552

The Federal Reserve System 553

Functions of the Federal Reserve 554

The Demand for Money 555

Interest Rates and Security Prices 556

ECONOMICS IN PRACTICE Professor Serebryakov Makes an Economic Error 557

How the Federal Reserve Controls the Interest Rate 558

Tools Prior to 2008 558

Expanded Fed Activities Beginning in 2008 559

The Federal Reserve Balance Sheet 560

Tools After 2008 561

Looking Ahead 562

Summary 562 Review Terms and Concepts 563 Problems 563

Appendix 566 Appendix Problems 568

26 The Determination of Aggregate Output, the Price Level, and the Interest Rate 569

The Aggregate Supply (AS) Curve 570

Aggregate Supply in the Short Run 570

Shifts of the Short-Run Aggregate Supply Curve 572

The Aggregate Demand (AD) Curve 573

Planned Aggregate Expenditure and the Interest Rate 573

The Behavior of the Fed 574

ECONOMICS IN PRACTICE Central Bankers: Does Personality Matter? 576

Deriving the AD Curve 577

ECONOMICS IN PRACTICE Central Banks and Price Stability: Which Prices to Look At? 578

The Final Equilibrium 579

Other Reasons for a Downward-Sloping AD Curve 580

The Long Run AS Curve 580

Potential GDP 581

ECONOMICS IN PRACTICE The Simple “Keynesian” Aggregate Supply Curve 582

Summary 583 Review Terms and Concepts 583 Problems 583

27 Policy Effects and Cost Shocks in the AS/AD Model 586

Fiscal Policy Effects 587

Fiscal Policy Effects in the Long Run 588

Monetary Policy Effects 589

The Fed’s Response to the Z Factors 589

Shape of the AD Curve When the Fed Cares More About the Price Level than Output 589

What Happens When There Is a Zero Interest Rate Bound? 590

Shocks to the System 591

Cost Shocks 591

ECONOMICS IN PRACTICE South African Prices Surge as Cape Town Goes Dry 592

Demand-Side Shocks 593

Expectations 593

Monetary Policy Since 1970 594

Inflation Targeting 595

Looking Ahead 596

Summary 596 Review Terms and Concepts 596 Problems 596

28 The Labor Market in the Macroeconomy 599

The Labor Market: Basic Concepts 600

The Classical View of the Labor Market 600

The Classical Labor Market and the Aggregate Supply Curve 602

The Unemployment Rate and the Classical View 602

Explaining the Existence of Unemployment 602

Efficiency Wage Theory 603

Imperfect Information 603

Minimum Wage Laws 603

Explaining the Existence of Cyclical

Unemployment 604

Sticky Wages 604

ECONOMICS IN PRACTICE Evidence on Sticky Wages 605

ECONOMICS IN PRACTICE How the Sharing Economy Is Transforming the Job Market 606

An Open Question 606

The Short-run Relationship Between the Unemployment Rate and Inflation 607

The Phillips Curve: A Historical Perspective 608

Aggregate Supply and Aggregate Demand Analysis and the Phillips Curve 610

Expectations and the Phillips Curve 611

Inflation and Aggregate Demand 611

The Long-run Aggregate Supply Curve, Potential Output, and the Natural Rate of Unemployment 612

The Nonaccelerating Inflation Rate of Unemployment (NAIRU) 613

Looking Ahead 614

Summary 614 Review Terms and Concepts 615 Problems 615

PART VI Further Macroeconomics Issues 618

29 Financial Crises, Stabilization, and Deficits 618

The Stock Market, the Housing Market, and Financial Crises 619

Stocks and Bonds 619

Determining the Price of a Stock 619

The Stock Market Since 1948 621

Housing Prices Since 1952 622

Household Wealth Effects on the Economy 623

Financial Crises and the 2008 Bailout 623

ECONOMICS IN PRACTICE Predicting an Economy's Future 624

Time Lags Regarding Monetary and Fiscal Policy 625

Recognition Lags 627
Implementation Lags 627
Response Lags 628
Summary 629

Government Deficit Issues 629

Deficit Targeting 629

Summary 631 Review Terms and Concepts 632 Problems 632

30 Household and Firm Behavior in the Macroeconomy: A Further Look 634

Households: Consumption and Labor Supply Decisions 635

The Life-Cycle Theory of Consumption 635
The Labor Supply Decision 636
Interest Rate Effects on Consumption 638
Government Effects on Consumption and Labor Supply: Taxes and Transfers 638
A Possible Employment Constraint on Households 639
A Summary of Household Behavior 640
The Household Sector Since 1970 640

ECONOMICS IN PRACTICE Measuring Housing Price Changes 641

Firms: Investment and Employment Decisions 643

Expectations and Animal Spirits 643
Excess Labor and Excess Capital Effects 644
Inventory Investment 645
A Summary of Firm Behavior 646
The Firm Sector Since 1970 646

Productivity and the Business Cycle 648

The Short-Run Relationship Between Output and Unemployment 649

The Size of the Multiplier 650

ECONOMICS IN PRACTICE Estimating Multipliers: the Mafia Link 651

Summary 651 Review Terms and Concepts 653 Problems 653

31 Long-Run Growth 655

The Growth Process: From Agriculture to Industry 656

Sources of Economic Growth 657

Increase in Labor Supply 657

ECONOMICS IN PRACTICE Government Strategy for Growth 658

Increase in Physical Capital 659

Increase in the Quality of the Labor Supply (Human Capital) 661

Increase in the Quality of Capital (Embodied Technical Change) 661

ECONOMICS IN PRACTICE Germany's Open Border Policy 662

Disembodied Technical Change 662

More on Technical Change 663

U.S. Labor Productivity: 1952 I–2017 IV 664

Growth and the Environment and Issues of Sustainability 665

Summary 667 Review Terms and Concepts 667 Problems 668

32 Alternative Views in Macroeconomics 671

Keynesian Economics 672

Monetarism 672

The Velocity of Money 672

The Quantity Theory of Money 673

The Keynesian/Monetarist Debate 674

Supply-Side Economics 675

The Laffer Curve 675

Evaluating Supply-Side Economics 676

New Classical Macroeconomics 677

The Development of New Classical Macroeconomics 677

Rational Expectations 678

ECONOMICS IN PRACTICE Brexit and Consumer Expectations 679

Real Business Cycle Theory and New Keynesian Economics 680

Evaluating the Rational Expectations Assumption 681

Behavioral Macroeconomics 682

Testing Alternative Macroeconomic Models 682

Summary 683 Review Terms and Concepts 684 Problems 684

PART VII The World Economy 687

33 International Trade, Comparative Advantage, and Protectionism 687

Trade Surpluses and Deficits 688

The Economic Basis for Trade: Comparative Advantage 688

Absolute Advantage versus Comparative Advantage 689

Terms of Trade 693

Exchange Rates 694

The Sources of Comparative Advantage 696

The Heckscher-Ohlin Theorem 696

Other Explanations for Observed Trade Flows 697

Trade Barriers: Tariffs, Export Subsidies, and Quotas 697

ECONOMICS IN PRACTICE Globalization Improves Firm Productivity 698

U.S. Trade Policies, GATT, and the WTO 699

ECONOMICS IN PRACTICE What Happens When We Lift a Quota? 699

Free Trade or Protection? 701

The Case for Free Trade 701

The Case for Protection 703

ECONOMICS IN PRACTICE Reshaping the Global Trade Order 705

An Economic Consensus 707

Summary 707 Review Terms and Concepts 708 Problems 708

34 Open-Economy Macroeconomics: The Balance of Payments and Exchange Rates 711

The Balance of Payments 712

The Current Account 712

The Financial Account 714

ECONOMICS IN PRACTICE Debtor and Creditor Nations 715

Equilibrium Output (Income) in an Open Economy 715

The International Sector and Planned Aggregate Expenditure 715

Imports, Exports, and the Trade Feedback Effect 718

Import and Export Prices and the Price Feedback Effect 718

The Open Economy with Flexible Exchange Rates 719

The Market for Foreign Exchange 720

Factors That Affect Exchange Rates 723

The Effects of Exchange Rates on the Economy 725

An Interdependent World Economy 728

Summary 728 Review Terms and Concepts 729 Problems 729 Appendix 731

35 Economic Growth in Developing Economies 737

Life in the Developing Nations: Population and Poverty 738

ECONOMICS IN PRACTICE What Can We Learn from the Height of Children? 739

Economic Development: Sources and Strategies 739

The Sources of Economic Development 740

ECONOMICS IN PRACTICE Corruption 742

Strategies for Economic Development 743

ECONOMICS IN PRACTICE Who You Marry May Depend on the Rain 745

Two Examples of Development: China and India 747

ECONOMICS IN PRACTICE Boosting Agricultural Income Through Digital Finance 748

Development Interventions 748

Random and Natural Experiments: Some New Techniques in Economic Development 749

Education Ideas 749

Health Improvements 750

Summary 751 Review Terms and Concepts 751 Problems 752

PART VIII Methodology 754

36 Critical Thinking about Research 754

Selection Bias 755

Causality 756

Correlation versus Causation 756

Random Experiments 757

Regression Discontinuity 758

ECONOMICS IN PRACTICE Moving to Opportunity 759

ECONOMICS IN PRACTICE Control Groups and Experimental Economics 760

Difference-in-Differences 761

ECONOMICS IN PRACTICE Using Difference-In-Differences to Study the Efficacy of Medical Insurance in Japan 762

Statistical Significance 763

Regression Analysis 764

Summary 766 Review Terms and Concepts 766 Problems 767

Glossary 769

Index 784

Credits 811

Preface

New to this Edition

Updates for this edition of *Principles of Economics* include:

- It is our hope that students will come to see both how broad the tools of economics are and how exciting is much of the new research in the field. The 13th edition has continued the changes in the *Economics in Practice* boxes that we began several editions ago. In these boxes, we aim to bring economic thinking to the concerns of the typical student. In many cases, we do this by spotlighting recent research, much of it by young scholars. Here are some examples of the topics we cover in the new boxes:
 - Research on the role weather plays in reducing school achievement in rural India by changing the importance of child labor in agriculture (Chapter 1, “The Scope and Method of Economics”).
 - The strength of the economics major in helping students avoid unemployment in a recession, showing how the skills students learn in an economics class can benefit them regardless of the career path they choose (Chapter 1, “The Scope and Method of Economics”).
 - The role of sugar taxes in determining a customer’s response to price changes in sugary beverages (Chapter 6, “Household Behavior and Consumer Choice”). This is one of the several new behavioral economics boxes we have in the new edition.
 - The Marshall Plan’s effects on managerial training and company productivity (Chapter 7, “The Production Process: The Behavior of Profit-Maximizing Firms”).
 - How researchers can use data on adopted children to explore whether generationally-correlated investing patterns are learned behavior or have some genetic component reflecting risk preference (Chapter 11, “Input Demand: The Capital Market and the Investment Decision”).
 - Most coders are men. How much does this have to do with gender identity? We discuss an experiment in Peru by a nonprofit to see if more women can be encouraged to go into this lucrative field (Chapter 18, “Income Distribution and Poverty”).
 - Whether shareholders or workers benefit from the 2017 Trump tax package’s big reduction in the corporate income tax (Chapter 19, “Public Finance: The Economics of Taxation”).
- We have reworked some of the chapters to streamline them and to improve readability. In the discussions of supply and demand and the discussions of perfect and imperfect competition, we have added simple algebraic material to the graphical, numeric and verbal explanations to aid in clarity of understanding.
 - Chapter 11, “Input Demand: The Capital Market and the Investment Decision,” has been considerably reworked to include a more thorough discussion of finance, that should be especially interesting to students who anticipate a career in the financial sector.
 - Chapter 18, “Income Distribution and Poverty,” has also been substantially reworked to reflect the increased worldwide concern with issues of inequality and economic mobility.
 - In Chapter 32, “Alternative Views in Macroeconomics,” a discussion of behavioral macroeconomics has been added to the Alternative views of macroeconomics.
- We continue to be very excited about Chapter 36, “Critical Thinking About Research.” This material is unique in an introductory economics text. This chapter covers the research methodology of economics, where we highlight some of the key concerns of empirical economics: selection issues, causality, statistical significance, and regression analysis. Methodology is a key part of economics these days, and we have tried to give the introductory student a sense of what this methodology is and how to apply it in class and beyond.
- All of the macro data have been updated through 2018. The slow recovery from the 2008–2009 recession is still evident in these data. This gives students a good idea of what has been happening to the economy since they left high school.

- Many end-of-chapter problems have been revised.
- We have added Critical Thinking questions to each Economics in Practice box and each end-of-chapter section, to reinforce the underlying economic principles and to give students practical application of what they've learned.

The *Principles of Economics* Program

Our goal in the 13th edition, as it was in the first edition, is to instill in students a fascination with both the functioning of the economy and the power and breadth of economics. The first line of every edition of our book has been “The study of economics should begin with a sense of wonder.” We hope that readers come away from our book with a basic understanding of how market economies function, an appreciation for the things they do well, and a sense of the things they do poorly. We also hope that readers begin to learn the art and science of economic thinking and begin to look at some policy, and, even personal decisions, in a different way. We have prepared this edition of the text and MyLab Economics with this in mind. To improve student results, we recommend pairing the text content with **MyLab Economics**, which is the teaching and learning platform that empowers you to reach every student. By combining trusted author content with digital tools and a flexible platform, MyLab personalizes the learning experience and will help your students learn and retain key course concepts while developing skills that future employers are seeking in their candidates. From **Digital Interactives** to **Real-time Data Analysis Exercises**, MyLab Economics helps you teach your course, your way. Learn more at www.pearson.com/mylab/economics.

Solving Teaching and Learning Challenges

As authors and teachers, we understand the challenges of the principles of economics course. The foundational themes of *Principles of Economics*, 13th edition, are to introduce the discipline of economics and to provide a basic understanding of how economies function. This requires a blend of economic theory, institutional material, and real-world applications. We have maintained a balance between these ingredients in every chapter. There is such volume of material for teachers to cover, and for students to understand. We address this learning challenge through: (1) A three-tiered approach of explaining key concepts through relevant stories, graphs and equations (2) Pedagogical features in the text and accompanying digital resources in MyLab Economics that illustrate and reinforce key concepts through real-world examples and applications that are relevant to students; (3) Graphs and animations; and (4) A wide variety of questions and problems.

Three-Tiered Explanations: Stories-Graphs-Equations

Professors who teach principles of economics are faced with a classroom of students with different abilities, backgrounds, and learning styles. For some students, analytical material is difficult no matter how it is presented; for others, graphs and equations seem to come naturally. The problem facing instructors and textbook authors alike is how to convey the core principles of the discipline to as many students as possible without selling the better students short. Our approach to this problem is to present most core concepts in the following three ways.

First, we present each concept in the context of a simple intuitive **story** or example in words often followed by a table. Second, we use a **graph** in most cases to illustrate the story or example. And finally, in many cases where appropriate, we use an **equation** to present the concept with a mathematical formula. In this edition, we have strengthened this element without greatly increasing mathematical levels needed for the class. For students who would benefit from a math review, MyLab Economics offers math skills review Chapter R, accessible from the assignment manager and containing over 150 graphing, algebra, and calculus exercises for homework, quiz, and test use.

Economics in Practice

We know that students are best motivated when they see the relevance of what they're learning to the world they live in. We've created *Economics in Practice* with a focus on recent research or events that support a key concept in the chapter and help students think about the broad and exciting applications of economics to their lives and the world around them. Each box contains a Critical Thinking question or two to further connect the material they are learning with their lives.


ECONOMICS IN PRACTICE

Have You Bought This Textbook?

As all of you know full well, college textbooks are expensive. At first, it may seem as though there are few substitutes available for the cash-strapped undergraduate. After all, if your professor assigns Smith's *Principles of Biology* to you, you cannot go out and see if Jones' *Principles of Chemistry* is perhaps cheaper and buy it instead. As it turns out, as some recent work by Judy Chevalier and Austan Goolsbee¹ discovered, even when instructors require particular texts, when prices are high students have found substitutes. Even in the textbook market student demand does slope down!

Chevalier and Goolsbee collected data on textbooks from more than 1600 colleges for the years 1997–2001 to do their research. For that period, the lion's share of both new and used college textbooks was sold in college bookstores. Next, they looked at class enrollments for each college in the large majors: economics, biology, and psychology. In each of those classes they were able to learn which textbook had been assigned. At first, one might think that the total number of textbooks, used plus new, should match the class enrollment. After all, the text is required! In fact, what they found was the higher the textbook price, the more text sales fell below class enrollments.

So what substitutes did students find for the required text? While the paper has no hard evidence on this, students themselves gave them lots of suggestions. Many decide to share books with roommates. Others use the library more. These solutions are not perfect, but when the price is high enough, students find it worth their while to walk to the library!



CRITICAL THINKING

1. If you were to construct a demand curve for a required text in a course, where would that demand curve intersect the horizontal axis?
2. And this much harder question: In the year before a new edition of a text is published, many college bookstores will not buy the older edition. Given this *fact*, what do you think happens to the gap between enrollments and new plus used book sales in the year before a new edition of a text is expected?

¹Judith Chevalier and Austan Goolsbee, "Are Durable Goods Consumers Forward Looking? Evidence From College Textbooks," *Quarterly Journal of Economics*, 2009: 1853–1884.

To further promote the relevance of economics, *Current News Exercises* provide a turn-key way to assign gradable news-based exercises in MyLab Economics. Each week, Pearson scours the news, finds a current microeconomics and macroeconomics news article or video, creates exercises around these news articles, and then automatically adds them to MyLab Economics. Assigning and grading current news-based exercises that deal with the latest micro and macro events and policy issues has never been more convenient.

Pearson Economic News

[Home](#)
[About](#)

Macroeconomic Weekly News Update

August 25, 2018 – August 31, 2018

What's Really Going On With China's Economy?

China / economic growth / exports / GDP / international trade

SEARCH

Microeconomic Weekly News Update

August 25, 2018 – August 31, 2018

Inside the High-Stakes Business of Tracking Space Junk

externalities / market failure / public goods / space trash / tragedy of the commons

CATEGORIES

- 01. Introductory Concepts (scarcity, opportunity cost, comparative advantage, and economic models)
- 02. Supply Demand and Market Equilibrium (applications of supply/demand model)
- 03. Market Efficiency and Surplus; Market Failure and Public Goods
- 04. Factors of Production, Labor, Technology and Costs
- 05. Market Structure (pricing, advertising, and game theory)
- 06. Macroeconomic Variables and Policy Goals
- 07. Growth, Development, and Financial Markets (long run)
- 08. Monetary Policy (short-run fluctuations)
- 09. Fiscal Policy (short-run fluctuations)
- 10. International Economics (trade and finance)

Concept Checks

Giving students the opportunity to practice what they are learning along the way is critical to their success in the principles of economics course. New for this edition, each section and subsection of each learning objective, and select key figures, is reinforced with a Concept Check in the eText of MyLab Economics that contains one or two multiple choice, true/false, or fill-in questions. These checks act as “speed bumps” that encourage students to stop and check their understanding of fundamental terms and concepts before moving on to the next section. The goal is to help students assess their progress on a section-by-section basis, so they can be better prepared for homework, quizzes, and exams.

The screenshot shows a homework page titled "Homework: Homework" with a "Save" button. The score is "0 of 1 pt" and the HW Score is "0%, 0 of 3 pts". The question is "Concept Check 2.3" and asks: "Assuming it chooses to produce, a profit-maximizing firm in a perfectly competitive industry will produce output where". The options are:

- A. marginal cost equals average total cost.
- B. the difference between marginal revenue and marginal cost is the greatest.
- C. marginal revenue equals marginal cost.
- D. marginal revenue equals average total cost.

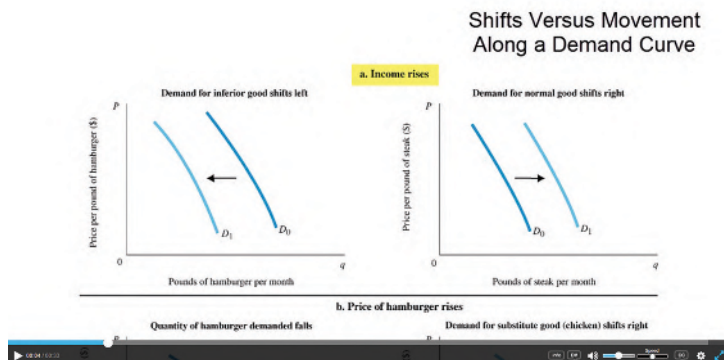
 At the bottom, there is a progress bar for "1 part remaining", a "Clear All" button, and a "Check Answer" button.

Graphing Animations

Graphs are the backbone of introductory economics, but many students struggle to understand and work with them. The Chapter 1 Appendix, “How to Read and Understand Graphs,” shows readers how to interpret the over 200 graphs featured in this book. To make interpreting graphs easier for students, we use red curves to illustrate the behavior of firms, blue curves to show the behavior of households, and a different shade of red and blue to signify a shift in a curve.

The figures in the book are also an integral part of our three-tiered approach to explain concepts in words, equations and graphs. They promote learning as students read an example or story, followed by a mathematical representation, and then see a graphical representation.

Select numbered figures in the text have a supporting animated version in MyLab Economics. The goal is to help students understand shifts in curves, movements along curves, and changes in equilibrium values by bringing graphs to life. Having an animated version of a graph helps students who have difficulty interpreting the static version in the printed text. Graded practice exercises are included with the animations to give students practice reading and interpreting graphs.



Real-Time Data

Currency is imperative in economics, particularly macroeconomics. We achieve this with real-time data analysis figures and exercises. Many of the key figures in the text have been updated in the MyLab with real-time data from the Federal Reserve's Economic Data (FRED™) — a comprehensive, up-to-date data set maintained by the Federal Reserve Bank of St. Louis. These animated graphs help students understand shifts in curves, movements along curves, and changes in equilibrium values. Easy to assign and automatically graded, Real-Time Data Analysis exercises use up-to-the-minute, real-time macroeconomic data. These exercises communicate directly with the Federal Reserve Bank of St. Louis's FRED™ site, so every time FRED posts new data, students see it.

The screenshot shows a homework interface for 'RTDA+: Unemployment'. It includes a score of 1 of 1 pt, a progress indicator (2 of 3 complete), and a homework score of 33.33% (1 of 3 pts). The question is titled 'Real-time data analysis exercise' and asks students to use FRED data to answer questions. A table of employment data for August 01, 2018, is provided.

Title	Series ID	Value
Unemployed	UNEMPLOY	6,234
Civilian Labour force	CLF16OV	161,776
Employment level-part-time for economic reasons...	LNS12032195	2,551

Using FRED, the series above are reported monthly, and the values are in thousands of persons.

Use the data in the table above to calculate two different unemployment rates. (Enter your responses rounded to two decimal places.)

The civilian unemployment rate is 3.89 %.

The civilian unemployment rate including persons who are underemployed (part-time for economic reasons) is 5.43 %.

Question is complete.

All parts showing

Critical Thinking Questions

Throughout the course, and after graduation, students need to demonstrate critical thinking skills in their work and careers. To help develop these essential skills, we've added a new section of Critical Thinking questions to give students practice in higher-order thinking. Available in MyLab Economics, each end-of-chapter problem set ends with a *Critical Thinking Questions* section. These questions ask students to think more deeply about the concepts they've learned in the chapter when answering them. These assignable essay questions can be used on homework, tests, or quizzes. They require manual scoring; however, each essay question includes a sample correct answer to make grading easy.

CRITICAL THINKING QUESTIONS

QUESTION 1 When an unemployed individual gives up looking for work and leaves the labor force, she is no longer considered unemployed. What happens to the unemployment rate as a result? Does this mean that the unemployment rate understates or overstates the problem of joblessness?

QUESTION 2 According to the Efficiency Wage Theory, employers occasionally pay workers more than the equilibrium wage in the market in order to increase productivity. Explain how this would lead to reduced turnover.

Problems and Solutions

Each chapter and appendix ends with a problem set that asks students to think about and apply what they've learned in the chapter. These problems are not simple memorization questions. Rather, they ask students to perform graphical analysis or to apply economics to a real-world situation or policy decision. More challenging problems are indicated by an asterisk. Many problems have been updated. These problems can be assigned and auto-graded in MyLab Economics and are available with optional just-in-time learning aids to help students

when they need it the most. Students can also practice these problems in the Study Plan. The Study Plan gives students personalized recommendations, practice opportunities, and learning aids to help them stay on track.

Developing Employability Skills

For students to succeed in a rapidly changing job market, they should be aware of their career options and how to go about developing the many skills they will need to do so. We focus on developing these skills in a variety of ways.

In the text, the *Economics in Practice* boxes help students think deeply about concepts and make connections between what they learn in class and how it can apply to their job in the real world. Chapter 1's *Economics in Practice* box explores how majoring in economics can help make students less vulnerable to recession. Chapter 11's *Economics in Practice* boxes highlight investment banking, the stock market, and investing strategies, topics of particular interest and relevance to students studying economics and finance.

In MyLab Economics, the *Critical Thinking Questions* and *Current News* exercises encourage application of skills that will contribute toward success in this course and in the future, regardless of each student's career path.

Table of Contents Overview

Microeconomic Structure

The organization of the microeconomic chapters continues to reflect our belief that the best way to understand how market economies operate—and the best way to understand basic economic theory—is to work through the perfectly competitive model first, including discussions of output markets (goods and services) and input markets (land, labor, and capital), and the connections between them before turning to noncompetitive market structures such as monopoly and oligopoly. When students understand how a simple, perfectly competitive system works, they can start thinking about how the pieces of the economy “fit together.” We think this is a better approach to teaching economics than some of the more traditional approaches, which encourage students to think of economics as a series of disconnected alternative market models. We also make extensive use of concrete examples, designed to help students see the power of the simple economic model. A mastery of this material is invaluable to students interested in careers in business and the public sector. Our core interest is in helping students to think about the world using economics.

Learning perfect competition first also enables students to see the power of the market system. It is impossible for students to discuss the efficiency of markets as well as the problems that arise from markets until they have seen how a simple, perfectly competitive market system produces and distributes goods and services. This is our purpose in Chapters 6 through 11.

Chapter 12, “General Equilibrium and the Efficiency of Perfect Competition,” is a pivotal chapter that links simple, perfectly competitive markets with a discussion of market imperfections and the role of government. Chapters 13 through 15 cover three noncompetitive market structures—monopoly, monopolistic competition, and oligopoly. Chapter 16 covers externalities, public goods, and social choice. Chapter 17 covers uncertainty and asymmetric information. Chapters 18 and 19 cover income distribution as well as taxation and government finance. Figure II.2 from page 142 gives you an overview of our structure.

Macroeconomic Structure

We remain committed to the view that it is a mistake simply to throw aggregate demand and aggregate supply curves at students in the first few chapters of a principles book. To understand the AS and AD curves, students need to know about the functioning of both the goods market and the money market. The logic behind the simple demand curve is wrong when it is applied to the relationship between aggregate demand and the price level. Similarly, the logic behind the simple supply curve is wrong when it is applied to the relationship between aggregate supply and the price level. We thus build up to the AS/AD model slowly.

The goods market is discussed in Chapters 23 and 24 (the *IS* curve). The money market is discussed in Chapter 25 (material behind the Fed rule). Everything comes together in Chapter 26, which derives the *AD* and *AS* curves and determines the equilibrium values of aggregate output, the price level, and the interest rate. This is the core chapter and where the Fed rule plays a major role. Chapter 27 then uses the model in Chapter 26 to analyze policy effects and cost shocks. Chapter 28 then brings in the labor market. Figure V.1 on page 493 gives you an overview of this structure.

One of the big issues in the organization of the macroeconomic material is whether long-run growth issues should be taught before short-run chapters on the determination of national income and countercyclical policy. In the last four editions, we moved a significant discussion of growth to Chapter 22, “Unemployment, Inflation, and Long-Run Growth,” and highlighted it. However, while we wrote Chapter 31, the major chapter on long-run growth, so that it can be taught before or after the short-run chapters, we remain convinced that it is easier for students to understand the growth issue once they have come to grips with the logic and controversies of short-run cycles, inflation, and unemployment.

Instructor Teaching Resources

The instructor supplements are designed to make teaching and testing flexible and easy and are available for *Micro*, *Macro*, and *Economics* volumes.

This program comes with the following teaching resources:

Supplements available to instructors at www.pearsonglobaleditions.com/case	Features of the Supplement
Instructor’s Manual authored by Tony Lima of California State University, East Bay	<ul style="list-style-type: none"> • Detailed Chapter Outlines include key terminology, teaching notes, and lecture suggestions. • Topics for Class Discussion provide topics and real-world situations that help ensure that economic concepts resonate with students. • Unique Economics in Practice features that are not in the main text provide extra real-world examples to present and discuss in class. • Teaching Tips provide tips for alternative ways to cover the material and brief reminders on additional help to provide students. These tips include suggestions for exercises and experiments to complete in class. • Extended Applications include exercises, activities, and experiments to help make economics relevant to students. • Solutions are provided for all problems in the book.
Test Bank authored by Randy Methenitis of Richland College and Richard Gosselin of Houston Community College	<ul style="list-style-type: none"> • Multiple-choice, true/false, short-answer, and graphing questions with these annotations: • Difficulty level (1 for straight recall, 2 for some analysis, 3 for complex analysis) • Type (Multiple-choice, true/false, short-answer, essay) • Topic (The term or concept the question supports) • Learning outcome • AACSB learning standard (Written and Oral Communication; Ethical Understanding and Reasoning; Analytical Thinking; Information Technology; Interpersonal Relations and Teamwork; Diverse and Multicultural Work; Reflective Thinking; Application of Knowledge)
Computerized TestGen	TestGen allows instructors to: <ul style="list-style-type: none"> • Customize, save, and generate classroom tests • Edit, add, or delete questions from the Test Item Files • Analyze test results • Organize a database of tests and student results.

PowerPoints

authored by Jim Lee of Dickinson State University

- Slides include all the graphs, tables, and equations in the textbook.
- PowerPoints meet accessibility standards for students with disabilities. Features include, but not limited to:
 - Keyboard and Screen Reader access
 - Alternative text for images
 - High color contrast between background and foreground colors

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