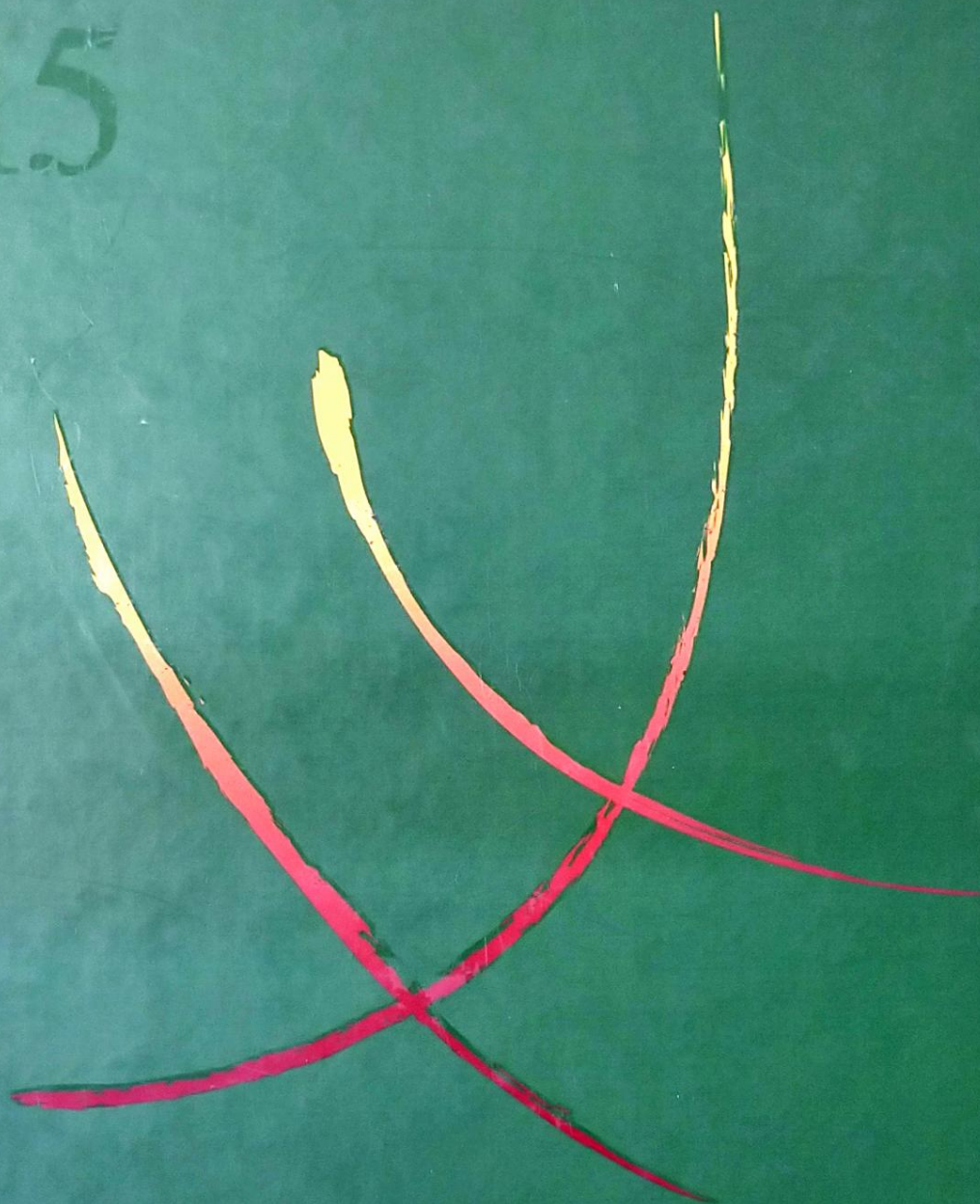


15



McCONNELL
BRUE

FIFTEENTH EDITION

Economics

Principles, Problems, and Policies

Campbell R. McConnell

*Professor of Economics, Emeritus
University of Nebraska*

Stanley L. Brue

*Professor of Economics
Pacific Lutheran University*

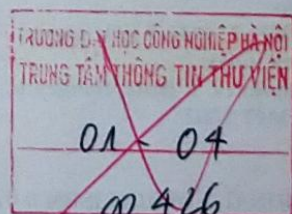


GIFT OF THE ASIA FOUNDATION
NOT FOR RE-SALE

QUÀ TẶNG CỦA QUỸ CHÂU Á
KHÔNG ĐƯỢC BÁN LẠI



**McGraw-Hill
Irwin**



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

To *Mem* and to *Terri* and *Craig*

McGraw-Hill Higher Education



A Division of The McGraw-Hill Companies

ECONOMICS: PRINCIPLES, PROBLEMS, AND POLICIES

Published by McGraw-Hill/Irwin, an imprint of The McGraw-Hill Companies, Inc. 1221 Avenue of the Americas, New York, NY, 10020. Copyright © 2002, 1999, 1996, 1993, 1990, 1987, 1984, 1981, 1978, 1975, 1972, 1969, 1966, 1963, 1960, by The McGraw-Hill Companies, Inc. All rights reserved. No part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written consent of The McGraw-Hill Companies, Inc., including, but not limited to, in any network or other electronic storage or transmission, or broadcast for distance learning.

Some ancillaries, including electronic and print components, may not be available to customers outside the United States.

This book is printed on acid-free paper.

domestic 5 6 7 8 9 0 VNH/VNH 0 9 8 7 6 5 4 3
international 5 6 7 8 9 0 VNH/VNH 0 9 8 7 6 5 4 3

ISBN 0-07-234036-3

ISBN 0-07-246137-3 (study guide)

Publisher: Gary Burke

Sponsoring editor: Lucille Sutton

Developmental editor: Erin Strathmann

Marketing manager: Martin Quinn

Senior project manager: Jean Lou Hess

Senior production supervisor: Lori Koettters

Interior and cover designer: Michael Warrell

Director of design: Keith J. McPherson

Last Word illustrator: Jacques Cournoyer

Lead supplement coordinator: Becky Szura

Senior producer media technology: Ed Przyzycki

Compositor: Techbooks

Typeface: 10/12 Janson

Printer: Von Hoffmann Press, Inc.

Library of Congress Cataloging-in-Publication Data

McConnell, Campbell R.

Economics: principles, problems, and policies/Campbell R. McConnell, Stanley R. Brue.—

15th ed.

p. cm.

ISBN-0-07-234036-3 (alk. paper)

Includes index.

1. Economics. I. Brue, Stanley L., 1945-II. Title.

HB171.5.M47 2002

330—dc21

2001037066

INTERNATIONAL EDITION ISBN 0-07-112322-9

Copyright © 2002. Exclusive rights by The McGraw-Hill Companies, Inc. for manufacture and export

This book cannot be re-exported from the country to which it is sold by McGraw-Hill.

The International Edition is not available in North America.

ABOUT THE AUTHORS

Campbell R. McConnell earned his Ph.D. from the University of Iowa after receiving degrees from Cornell College and the University of Illinois. He taught at the University of Nebraska–Lincoln from 1953 until his retirement in 1990. He is also co-author of *Contemporary Labor Economics*, 6th ed. (McGraw-Hill/Irwin) and has edited readers for the principles and labor economics courses. He is a recipient of both the University of Nebraska Distinguished Teaching Award and the James A. Lake Academic Freedom Award and is past president of the Midwest Economics Association. Professor McConnell was awarded an honorary Doctor of Laws degree from Cornell College in 1973 and received its Distinguished Achievement Award in 1994. His primary areas of interest are labor economics and economic education. He has an extensive collection of jazz recordings and enjoys reading jazz history.

Stanley L. Brue did his undergraduate work at Augustana College (SD) and received its Distinguished Achievement Award in 1991. He received his Ph.D. from the University of Nebraska–Lincoln. He is a professor at Pacific Lutheran University, where he has been honored as a recipient of the Burlington Northern Faculty Achievement Award. Professor Brue has also received the national Leavey Award for excellence in economic education. He has served as national president and chair of the Board of Trustees of Omicron Delta Epsilon International Economics Honorary. He is co-author of *Economic Scenes*, 5th edition (Prentice-Hall) and *Contemporary Labor Economics*, 6th edition (McGraw-Hill/Irwin) and author of *The Evolution of Economic Thought*, 6th edition (Harcourt). For relaxation, he enjoys international travel, attending sporting events, and skiing with family and friends.

LIST OF KEY GRAPHS

2-1 The Production Possibilities Curve	26	23-3 The Short-Run Profit-Maximizing Position of a Purely Competitive Firm	445
2-6 The Circular Flow Diagram	35	23-6 The $P=MC$ Rule and the Competitive Firm's Short-Run Supply Curve	448
3-5 Equilibrium Price and Quantity	51	23-12 The Long-Run Equilibrium Position of a Competitive Firm: $P=MC=$ Minimum ATC	456
9-2 (a) Consumption and (b) Saving Schedules	162	24-4 The Profit-Maximizing Position of a Pure Monopolist	470
9-5 The Investment Demand Curve	168	25-1 A Monopolistically Competitive Firm	489
9-9 Equilibrium GDP	175	25-4 The Kinked-Demand Curve	498
10-8 Recessionary and Inflationary Gaps	195	28-3 Labor Supply and Labor Demand in (a) A Purely Competitive Labor Market and (b) A Single Competitive Firm	554
11-7 The Equilibrium Price Level & Equilibrium Real GDP	214	37-2 Trading Possibility Lines and the Gains from Trade	735
13-1 The Demand for Money and the Money Market	252	38-1 The Market for Foreign Currency (Pounds)	757
15-2 Monetary Policy and Equilibrium GDP	290		
21-1 Total and Marginal Utility	396		
22-2 The Law of Diminishing Returns	420		
22-5 The Relationship of the Marginal-Cost Curve to the Average-Total-Cost and Average-Variable-Cost Curves	424		
22-8 The Long-Run Average-Total-Cost Curve: Unlimited Number of Plant Sizes	428		

BRIEF CONTENTS

PART ONE

An Introduction to Economics and the Economy

- To the Student 2
- 1 The Nature and Method of Economics 3
- 2 The Economizing Problem 22
- 3 Individual Markets: Demand and Supply 40
- 4 The Market System 59
- 5 The U.S. Economy:
Private and Public Sectors 73
- 6 The United States in the
Global Economy 93

PART TWO

National Income, Employment, and Fiscal Policy

- 7 Measuring Domestic Output, National
Income, and the Price Level 116
- 8 Introduction to Economic Growth and
Instability 136
- 9 Building the Aggregate Expenditures
Model 159
- 10 Aggregate Expenditures: The Multiplier, Net
Exports, and Government 182
- 11 Aggregate Demand and Aggregate
Supply 203
- 12 Fiscal Policy 224

PART THREE

Money, Banking, and Monetary Policy

- 13 Money and Banking 244
- 14 How Banks and Thrifts Create Money 265
- 15 Monetary Policy 282

PART FOUR

Long-Run Perspectives and Macroeconomic Debates

- 16 Extending the Analysis of
Aggregate Supply 306
- 17 Economic Growth and
the New Economy 323
- 18 Deficits, Surpluses, and the Public Debt 341
- 19 Disputes over Macro Theory and Policy 355

PART FIVE

Microeconomics of Product Markets

- 20 Supply and Demand: Elasticities and
Government-Set Prices 374
- 21 Consumer Behavior and
Utility Maximization 394
- 22 The Costs of Production 415
- 23 Pure Competition 437
- 24 Pure Monopoly 463
- 25 Monopolistic Competition and
Oligopoly 486
- 26 Technology, R&D, and Efficiency 510

PART SIX

Microeconomics of Resource Markets

- 27 The Demand for Resources 532
- 28 Wage Determination 550
- 29 Rent, Interest, and Profit 572

PART SEVEN

Microeconomics of Government

- 30 Government and Market Failure 588
- 31 Public Choice Theory and the Economics of
Taxation 611

PART EIGHT

Microeconomic Issues and Policies

- 32 Antitrust Policy and Regulation 632
- 33 Agriculture: Economics and Policy 649
- 34 Income Inequality and Poverty 667
- 35 Labor Market Issues:
Unionism, Discrimination, Immigration 687
- 36 The Economics of Health Care 710

PART NINE

International Economics and the World Economy

- 37 International Trade 730
- 38 Exchange Rates, the Balance of Payments, and
Trade Deficits 752
- 39 The Economics of Developing Countries 773

WEB BONUS CHAPTER

Transition Economies: Russia and China

- www.mhhe.com/economics/mcconnell15
- Glossary G-1
- Index I-1

List of Key Graphs	vi
Preface	vii
Contributors	xiv

PART ONE

An Introduction to Economics and the Economy

To the Student 2

1 The Nature and Method of Economics 3

The Economic Perspective 3

Scarcity and Choice/Rational Behavior/Marginalism: Benefits and Costs

Why Study Economics? 5

Economics for Citizenship/Professional and Personal Applications

Economic Methodology 6

Theoretical Economics/Policy Economics

Macroeconomics and Microeconomics 9

Macroeconomics/Microeconomics/Positive and Normative Economics

Pitfalls to Objective Thinking 10

Biases/Loaded Terminology/Definitions/Fallacy of Composition/Causation Fallacies

A Look Ahead 12

Last Word: Fast-Food Lines:
An Economic Perspective 12

Appendix Chapter 1: Graphs and Their Meaning 15

Construction of a Graph/Direct and Inverse Relationships/Dependent and Independent Variables/Other Things Equal/Slope of a Line/Vertical Intercept/Equation of a Linear Relationship/Slope of a Nonlinear Curve

2 The Economizing Problem 22

The Foundation of Economics 22

Unlimited Wants/Scarce Resources

Economics: Employment and Efficiency 24
Full Employment: Using Available Resources/Full Production: Using Resources Efficiently/Production Possibilities Table/Production Possibilities Curve/Law of Increasing Opportunity Cost/Allocative Efficiency Revisited

Unemployment, Growth, and the Future 29
Unemployment and Productive Inefficiency/A Growing Economy/A Qualification: International Trade/Examples and Applications

Economic Systems 33

The Market System/The Command System

The Circular Flow Model 34

Last Word: Women and Expanded Production Possibilities 36

3 Individual Markets: Demand and Supply 40

Markets 40

Demand 41

Law of Demand/The Demand Curve/Market Demand/Change in Demand/Changes in Quantity Demanded

Supply 46

Law of Supply/The Supply Curve/Determinants of Supply/Changes in Supply/Changes in Quantity Supplied

Supply and Demand: Market Equilibrium 49
Surpluses/Shortages/Equilibrium Price and Quantity/Rationing Function of Prices/Changes in Supply, Demand, and Equilibrium/A Reminder: "Other Things Equal"/Application: Pink Salmon

Last Word: Ticket Scalping: A Bum Rap? 55

4 The Market System 59

Characteristics of the Market System 59
Private Property/Freedom of Enterprise and Choice/Self-Interest/Competition/Markets and Prices/Reliance on Technology and Capital Goods/Specialization/Use of Money/Active, but Limited, Government

- The Market System at Work 64**
What Will Be Produced?/How Will the Goods and Services Be Produced?/Who Will Get the Goods and Services?/How Will the System Accommodate Change?
- Competition and the Invisible Hand 68**
- Last Word: Shuffling the Deck 69**
- 5 The U.S. Economy: Private and Public Sectors 73**
- Households as Income Receivers 73**
The Functional Distribution of Income/The Personal Distribution of Income
- Households as Spenders 74**
Personal Taxes/Personal Saving/Personal Consumption Expenditures
- The Business Population 76**
- Legal Forms of Businesses 76**
Advantages and Disadvantages/The Principal-Agent Problem
- The Public Sector: Government's Role 79**
Providing the Legal Structure/Maintaining Competition/Redistributing Income/Reallocating Resources/Promoting Stability
- The Circular Flow Revisited 83**
- Government Finance 84**
Government Purchases and Transfers
- Federal Finance 85**
Federal Expenditures/Federal Tax Revenues
- State and Local Finance 87**
State Finances/Local Finances/Fiscal Federalism
- Last Word: The Financing of Corporate Operations 89**
- 6 The United States in the Global Economy 93**
- International Linkages 93**
- The United States and World Trade 94**
Volume and Pattern/Rapid Trade Growth/Participants in International Trade
- Specialization and Comparative Advantage 98**
Basic Principle/Comparative Costs/Terms of Trade/Gains from Specialization and Trade
- The Foreign Exchange Market 101**
Dollar-Yen Market/Changing Rates: Depreciation and Appreciation
- Government and Trade 104**
Trade Impediments and Subsidies/Why Government Trade Interventions?/Costs to Society
- Multilateral Trade Agreements and Free-Trade Zones 105**
Reciprocal Trade Agreements Act/General Agreement on Tariffs and Trade/World Trade Organization/The European Union/North American Free Trade Agreement
- Increased Global Competition 108**
- Last Word: Buy American: The Global Refrigerator 110**
- PART TWO**
National Income, Employment, and Fiscal Policy
- 7 Measuring Domestic Output, National Income, and the Price Level 116**
- Assessing the Economy's Performance 116**
- Gross Domestic Product 117**
A Monetary Measure/Avoiding Multiple Counting/GDP Excludes Nonproduction Transactions/Two Ways of Looking at GDP: Spending and Income
- The Expenditures Approach 119**
Personal Consumption Expenditures (C)/Gross Private Domestic Investment (I_g)/Government Purchases (G)/Net Exports (X_n)/Putting It All Together: $GDP = C + I_g + G + X_n$
- The Income Approach 122**
Compensation of Employees/Rents/Interest/Proprietors' Income/Corporate Profits/From National Income to GDP
- Other National Accounts 124**
Net Domestic Product/National Income/Personal Income/Disposable Income/The Circular Flow Revisited
- Nominal GDP versus Real GDP 127**
Adjustment Process in a One-Product Economy/An Alternative Method/Real-World Considerations and Data

- The Consumer Price Index** 129
- Shortcomings of GDP** 130
Nonmarket Transactions/Leisure/Improved Product Quality/The Underground Economy/GDP and the Environment/Composition and Distribution of Output/Per Capita Output/Noneconomic Sources of Well-Being
- Last Word: Feeding the GDP Accounts** 132
- 8 Introduction to Economic Growth and Instability** 136
- Economic Growth** 136
Growth as a Goal/Arithmetic of Growth/Main Sources of Growth/Growth in the United States/Relative Growth Rates
- The Business Cycle** 138
Phases of the Business Cycle/Causation: A First Glance/Cyclical Impact: Durables and Nondurables
- Unemployment** 140
Measurement of Unemployment/Types of Unemployment/Definition of Full Employment/Economic Cost of Unemployment/Noneconomic Costs/International Comparisons
- Inflation** 146
Meaning of Inflation/Measurement of Inflation/Facts of Inflation/Types of Inflation/Complexities
- Redistribution Effects of Inflation** 149
Who Is Hurt by Inflation?/Who Is Unaffected or Helped by Inflation?/Anticipated Inflation/Addenda
- Effects of Inflation on Output** 152
Cost-Push Inflation and Real Output/Demand-Pull Inflation and Real Output/Hyperinflation and Breakdown
- Last Word: The Stock Market and the Economy** 155
- 9 Building the Aggregate Expenditures Model** 159
- Simplifications** 159
Tools of the Aggregate Expenditures Model
- Consumption and Saving** 160
Income-Consumption and Income-Saving Relationships/The Consumption Schedule/The Saving Schedule/Average and Marginal Propensities/Nonincome Determinants of Consumption and Saving/Terminology, Shifts, and Stability
- Investment** 166
Expected Rate of Return/The Real Interest Rate/Investment Demand Curve/Shifts in the Investment Demand Curve/Investment Schedule/Instability of Investment
- Equilibrium GDP** 172
Tabular Analysis/Graphical Analysis
- Other Features of Equilibrium GDP** 174
Saving Equals Planned Investment/No Unplanned Changes in Inventories
- Last Word: Say's Law, the Great Depression, and Keynes** 177
- 10 Aggregate Expenditures: The Multiplier, Net Exports, and Government** 182
- Changes in Equilibrium GDP and the Multiplier** 182
The Multiplier Effect
- International Trade and Equilibrium Output** 186
Net Exports and Aggregate Expenditures/The Net Export Schedule/Net Exports and Equilibrium GDP/International Economic Linkages
- Adding the Public Sector** 189
Simplifying Assumptions/Government Purchases and Equilibrium GDP/Taxation and Equilibrium GDP/Balanced-Budget Multiplier
- Equilibrium versus Full-Employment GDP** 194
Recessionary Gap/Inflationary Gap
- Applications of the Model** 196
The Great Depression in the United States/Vietnam War Inflation/The End of the Japanese Growth "Miracle"
- Limitations of the Model** 198
- Last Word: Squaring the Economic Circle** 199
- 11 Aggregate Demand and Aggregate Supply** 203
- Aggregate Demand** 203
Aggregate Demand Curve/Derivation of the Aggregate Demand Curve from the Aggregate Expenditures Model/Determinants of Aggregate Demand/Aggregate Demand Shifts and the Aggregate Expenditures Model

Aggregate Supply 209*Aggregate Supply Curve/Determinants of Aggregate Supply***Equilibrium: Real Output and the Price Level 214****Changes in Equilibrium 215***Increases in AD: Demand-Pull Inflation/Multiplier with Price-Level Changes/Decreases in AD: Recession and Cyclical Unemployment/Decreases in AS: Cost-Push Inflation/Increases in AS: Full Employment with Price-Level Stability***Last Word: Why Is Unemployment in Europe So High? 220****12 Fiscal Policy 224****Legislative Mandates 224****Fiscal Policy and the AD-AS Model 225***Expansionary Fiscal Policy/Contractionary Fiscal Policy/Financing of Deficits and Disposing of Surpluses/Policy Options: G or T***Built-In Stability 229***Automatic or Built-In Stabilizers***Evaluating Fiscal Policy 230***Full-Employment Budget/Recent U.S. Fiscal Policy***Problems, Criticisms, and****Complications 233***Problems of Timing/A Political Business Cycle?/Offsetting State and Local Finance/Crowding-Out Effect/Fiscal Policy, Aggregate Supply, and Inflation/Fiscal Policy in the Open Economy/Supply-Side Fiscal Policy***Last Word: The Leading Indicators 239****PART THREE****Money, Banking, and Monetary Policy****13 Money and Banking 244****The Functions of Money 244****The Supply of Money 245***Money Definition M1/Money Definition M2/Money Definition M3/Credit Cards***What "Backs" the Money Supply? 248***Money as Debt/Value of Money/Money and Prices/Stabilization of Money's Value***The Demand for Money 251***Transactions Demand, D_t /Asset Demand, D_a /Total Money Demand, D_m* **The Money Market 253***Adjustment to a Decline in the Money Supply/Adjustment to an Increase in the Money Supply***The Federal Reserve and the Banking System 254***Historical Background/Board of Governors/Assistance and Advice/The 12 Federal Reserve Banks/Commercial Banks and Thrifts/Fed Functions and the Money Supply/Federal Reserve Independence***Recent Developments in Money and Banking 258***The Relative Decline of Banks and Thrifts/Consolidation among Banks and Thrifts/Convergence of Services Provided by Financial Institutions/Globalization of Financial Markets/Electronic Transactions***Last Word: The Global Greenback 261****14 How Banks and Thrifts Create Money 265****The Balance Sheet of a Commercial Bank 265****Prologue: The Goldsmiths 265****A Single Commercial Bank 266***Formation of a Commercial Bank/Money-Creating Transactions of a Commercial Bank/Profits, Liquidity, and the Federal Funds Market***The Banking System: Multiple-Deposit Expansion 274***The Banking System's Lending Potential/The Monetary Multiplier/Some Modifications/Need for Monetary Control***Last Word: The Bank Panics of 1930 to 1933 278****15 Monetary Policy 282****Consolidated Balance Sheet of the Federal Reserve Banks 282***Assets/Liabilities*

Tools of Monetary Policy 284

Open-Market Operations/The Reserve Ratio/The Discount Rate/Easy Money and Tight Money/Relative Importance

Monetary Policy, Real GDP, and the Price Level 291

Cause-Effect Chain/Effects of an Easy Money Policy/Effects of a Tight Money Policy/Monetary Policy and Aggregate Supply

Effectiveness of Monetary Policy 294

Strengths of Monetary Policy/Shortcomings and Problems/Targeting the Federal Funds Rate/Monetary Policy and the International Economy

The "Big Picture" 298

Last Word: For the Fed, Life Is a Metaphor 299

PART FOUR***Long-Run Perspectives and Macroeconomic Debates*****16 Extending the Analysis of Aggregate Supply 306****Short-Run and Long-Run Aggregate Supply 306**

Short-Run Aggregate Supply/Long-Run Aggregate Supply/Equilibrium in the Extended AD-AS Model

Applying the Extended AD-AS Model 309

Demand-Pull Inflation in the Extended AD-AS Model/Cost-Push Inflation in the Extended AD-AS Model/Recession and the Extended AD-AS Model

The Inflation-Unemployment Relationship 311

The Phillips Curve/Aggregate Supply Shocks and the Phillips Curve

The Long-Run Phillips Curve 315

Short-Run Phillips Curve/Long-Run Vertical Phillips Curve/Disinflation

Taxation and Aggregate Supply 317

Taxes and Incentives to Work/Incentives to Save and Invest/The Laffer Curve/Criticisms of the Laffer Curve

Last Word: Has the Impact of Oil Prices Diminished? 319

17 Economic Growth and the New Economy 323**Ingredients of Growth 323**

Supply Factors/Demand Factor/Efficiency Factor

Production Possibilities Analysis 324

Growth and Production Possibilities/Labor and Productivity/Growth in the AD-AS Model

U.S. Economic Growth Rates 327**Accounting for Growth 328**

Inputs versus Productivity/Quantity of Labor/Technological Advance/Quantity of Capital/Education and Training/Resource Allocation and Economies of Scale/Other Factors

Productivity Growth and the New Economy 331

Characteristics of the New Economy/Macroeconomic Implications/Skepticism about the New Economy

Is Growth Desirable and Sustainable? 336

The Antigrowth View/In Defense of Economic Growth

Last Word: Some Pleasant Side Effects of the New Economy 338

18 Deficits, Surpluses, and the Public Debt 341**Deficits, Surpluses, and Debt: Definitions 341****Budget Philosophies 341**

Annually Balanced Budget/Cyclically Balanced Budget/Functional Finance

The Public Debt: Facts and Figures 342

Causes/Quantitative Aspects/Social Security Considerations

False Concerns 345

Bankruptcy/Burdening Future Generations

Substantive Issues 346

Income Distribution/Incentives/Foreign-Owned Public Debt/Crowding Out and the Stock of Capital

Deficits and Surpluses: 1990–2010 348**Options for the Surpluses 349**

Pay Down the Public Debt/Reduce Taxes/Increase Government Expenditures/Bolster the Social Security Trust Fund/Combinations of Policies

23 Pure Competition 437

Four Market Models 437

Pure Competition: Characteristics and Occurrence 438

Relevance of Pure Competition

Demand as Seen by a Purely Competitive Seller 439

Perfectly Elastic Demand/Average, Total, and Marginal Revenue/Graphical Portrayal

Profit Maximization in the Short Run 440

Total-Revenue-Total-Cost Approach: Profit-Maximization Case/Marginal-Revenue-Marginal-Cost Approach

Marginal Cost and Short-Run Supply 447

Generalized Depiction/Diminishing Returns, Production Costs, and Product Supply/Changes in Supply/Firm and Industry: Equilibrium Price

Profit Maximization in the Long Run 451

Assumptions/Goal of Our Analysis/Long-Run Equilibrium/Long-Run Supply for a Constant-Cost Industry/Long-Run Supply for an Increasing-Cost Industry/Long-Run Supply for a Decreasing-Cost Industry

Pure Competition and Efficiency 455

Productive Efficiency: $P = \text{Minimum ATC}$ /Allocative Efficiency: $P = MC$

Last Word: Pure Competition and Consumer Surplus 459

24 Pure Monopoly 463

An Introduction to Pure Monopoly 463

Examples of Monopoly/Dual Objectives of the Study of Monopoly

Barriers to Entry 464

Economies of Scale/Legal Barriers to Entry: Patents and Licenses/Ownership or Control of Essential Resources/Pricing and Other Strategic Barriers to Entry

Monopoly Demand 466

Marginal Revenue Is Less Than Price/The Monopolist Is a Price Maker/The Monopolist Sets Prices in the Elastic Region of Demand

Output and Price Determination 469

Cost Data/MR = MC Rule/No Monopoly Supply Curve/Misconceptions Concerning Monopoly Pricing/Possibility of Losses by Monopolist

Economic Effects of Monopoly 472

Price, Output, and Efficiency/Income Transfer/Cost Complications/Assessment and Policy Options

Price Discrimination 477

Conditions/Examples of Price Discrimination/Consequences of Price Discrimination

Regulated Monopoly 479

Socially Optimal Price: $P = MC$ /Fair-Return Price: $P = ATC$ /Dilemma of Regulation

Last Word: De Beers' Diamonds:

Are Monopolies Forever? 482

25 Monopolistic Competition and Oligopoly 486

Monopolistic Competition 486

Relatively Large Number of Sellers/Differentiated Products/Easy Entry and Exit/Advertising/Monopolistically Competitive Industries

Price and Output in Monopolistic Competition 488

The Firm's Demand Curve/The Short Run: Profit or Loss/The Long Run: Only a Normal Profit

Monopolistic Competition and Efficiency 491

Neither Productive nor Allocative Efficiency/Excess Capacity

Product Variety 492

Benefits of Product Variety/Further Complexity

Oligopoly 493

A Few Large Producers/Homogeneous or Differentiated Products/Control over Price, but Mutual Interdependence/Entry Barriers/Mergers/Measures of Industry Concentration

Oligopoly Behavior: A Game-Theory Overview 495

Mutual Interdependence Revisited/Collusive Tendencies/Incentive to Cheat

Three Oligopoly Models 497

Kinked-Demand Theory: Noncollusive Oligopoly/Cartels and Other Collusion/Price Leadership Model

Oligopoly and Advertising 503

Positive Effects of Advertising/Potential Negative Effects of Advertising

Oligopoly and Efficiency 505

Productive and Allocative Efficiency/Qualifications

Last Word: Oligopoly in the Beer Industry 506

26 Technology, R&D, and Efficiency 510

Technological Advance: Invention, Innovation, and Diffusion 511

Invention/Innovation/Diffusion/R&D Expenditures/Modern View of Technological Advance

Role of Entrepreneurs and Other Innovators 513

Forming Start-Ups/Innovating within Existing Firms/Anticipating the Future/Exploiting University and Government Scientific Research

A Firm's Optimal Amount of R&D 514

Interest-Rate Cost of Funds/Expected Rate of Return/Optimal R&D Expenditures

Increased Profit via Innovation 517

Increased Revenue via Product Innovation/Reduced Cost via Process Innovation

Imitation and R&D Incentives 520

Benefits of Being First

Role of Market Structure 522

Market Structure and Technological Advance/Inverted-U Theory/Market Structure and Technological Advance: The Evidence

Technological Advance and Efficiency 524

Productive Efficiency/Allocative Efficiency/Creative Destruction

Last Word: On the Path to the Personal Computer and Internet 526

PART SIX

Microeconomics of Resource Markets

27 The Demand for Resources 532

Significance of Resource Pricing 532

Marginal Productivity Theory of Resource Demand 533

Resource Demand as a Derived Demand/Marginal Revenue Product/Rule for Employing Resources: $MRP = MRC$ /MRP as Resource Demand Schedule/Resource Demand under Imperfect Product Market Competition/Market Demand for a Resource

Determinants of Resource Demand 537

Changes in Product Demand/Changes in Productivity/Changes in the Prices of Other Resources/Occupational Employment Trends

Elasticity of Resource Demand 541

Optimal Combination of Resources 542

The Least-Cost Rule/The Profit-Maximizing Rule/Numerical Illustration

Marginal Productivity Theory of Income Distribution 545

Last Word: Input Substitution: The Case of ATMs 546

28 Wage Determination 550

Labor, Wages, and Earnings 550

General Level of Wages 551

Role of Productivity/Real Wages and Productivity/Secular Growth of Real Wages

A Purely Competitive Labor Market 552

Market Demand for Labor/Market Supply of Labor/Labor Market Equilibrium

Monopsony Model 555

Upward-Sloping Labor Supply to Firm/MRC Higher than the Wage Rate/Equilibrium Wage and Employment/Examples of Monopsony Power

Three Union Models 557

Demand-Enhancement Model/Exclusive or Craft Union Model/Inclusive or Industrial Union Model/Wage Increases and Unemployment

Bilateral Monopoly Model 561

Indeterminate Outcome of Bilateral Monopoly/Desirability of Bilateral Monopoly

The Minimum-Wage Controversy 562

Case against the Minimum Wage/Case for the Minimum Wage/Evidence and Conclusions

Wage Differentials 563

Marginal Revenue Productivity/Noncompeting Groups/Compensating Differences/Market Imperfections

Pay for Performance 566

The Principal-Agent Problem Revisited/Addenda: Negative Side Effects of Pay for Performance

Last Word: Of African-Style Hairbraiders and Stodgy Economists 569

29 Rent, Interest, and Profit 572

Economic Rent 572

Perfectly Inelastic Supply/Changes in Demand/Land Rent: A Surplus Payment/Application: A Single Tax on Land/Productivity Differences and Rent Differences/Alternative Uses of Land

Interest 575

Loanable Funds Theory of Interest/Extending the Model/Range of Interest Rates/Pure Rate of Interest/Role of the Interest Rate/Application: Usury Laws

Economic Profit 581

Role of the Entrepreneur/Sources of Economic Profit/Functions of Profit

Income Shares 583

Last Word: Determining the Price of Credit 584

PART SEVEN

Microeconomics of Government

30 Government and Market Failure 588

Public Goods 588

Demand for Public Goods/Supply of Public Goods/Optimal Quantity of a Public Good/Cost-Benefit Analysis

Externalities Revisited 592

Spillover Costs/Spillover Benefits/Individual Bargaining: Coase Theorem/Liability Rules and Lawsuits/Government Intervention/A Market-Based Approach to Spillover Costs/Society's Optimal Amount of Externality Reduction/Solid-Waste Disposal and Recycling/Global Warming

Information Failures 603

Inadequate Information Involving Sellers/Inadequate Information Involving Buyers/Qualification

Last Word: Lojack: A Case of Positive Externalities 607

31 Public Choice Theory and the Economics of Taxation 611

Revealing Preferences through Majority Voting 611

Inefficient Voting Outcomes/Paradox of Voting/Median-Voter Model

Government Failure 615

Special Interests and Rent Seeking/Clear Benefits, Hidden Costs/Limited and Bundled Choice/Bureaucracy and Inefficiency/Imperfect Institutions

Apportioning the Tax Burden 618

Benefits Received versus Ability to Pay/Progressive, Proportional, and Regressive Taxes

Tax Incidence and Efficiency Loss 620

Elasticity and Tax Incidence/Efficiency Loss of a Tax/Probable Incidence of U.S. Taxes/The U.S. Tax Structure

The Issue of Freedom 626

The Conservative Position/The Liberal Position

Last Word: "Government Failure" in the News 627

PART EIGHT

Microeconomic Issues and Policies

32 Antitrust Policy and Regulation 632

The Antitrust Laws 632

Historical Background/Sherman Act of 1890/Clayton Act of 1914/Federal Trade Commission Act of 1914/Celler-Kefauver Act of 1950

Antitrust Policy: Issues and Impacts 634

Issues of Interpretation/Issues of Enforcement: Tradeoffs among Goals/Effectiveness of Antitrust Laws

Industrial Regulation 639

Natural Monopoly/Problems with Industrial Regulation/Legal Cartel Theory

Deregulation 641

Controversy/Outcomes of Deregulation

Social Regulation 642

Distinguishing Features/The Optimal Level of Social Regulation/Two Reminders

Last Word: The Microsoft Antitrust Case 646

33 Agriculture: Economics and Policy 649

Economics of Agriculture 650

Short-Run Problem: Price and Income Instability/Long-Run Problem: A Declining Industry

- Economics of Farm Policy 655**
Rationale for Farm Subsidies/Background; The Parity Concept/Economics of Price Supports/Reduction of Surpluses
- Criticism, Politics, and Reform 660**
Criticisms/The Politics of Farm Policy/Recent Reform: Freedom to Farm
- Last Word: The Sugar Program: A Sweet Deal 664**
- 34 Income Inequality and Poverty 667**
- Facts about Income Inequality 667**
Distribution of Personal Income by Income Category/Distribution of Personal Income by Quintiles (Fifths)/The Lorenz Curve/Income Mobility: The Time Dimension/Effect of Government Redistribution
- Causes of Income Inequality 670**
Ability/Education and Training/Discrimination/Preferences and Risks/Unequal Distribution of Wealth/Market Power/Luck, Connections, and Misfortune
- Trends in Income Inequality 672**
Causes of Growing Inequality
- Equality versus Efficiency 674**
The Case for Equality: Maximizing Total Utility/The Case for Inequality: Incentives and Efficiency/The Equality-Efficiency Tradeoff
- The Economics of Poverty 676**
Definition of Poverty/Incidence of Poverty/Poverty Trends/The "Invisible" Poor
- The Income-Maintenance System 678**
Social Insurance Programs/Public Assistance Programs
- Welfare: Goals and Conflicts 680**
Common Features/Conflicts among Goals
- Welfare Reform 681**
Temporary Assistance to Needy Families/Assessment of TANF
- Last Word: Some Facts on U.S. Wealth and Its Distribution 683**
- 35 Labor Market Issues: Unionism, Discrimination, Immigration 687**
- Unionism in America 687**
Business Unionism/Union Membership/The Decline of Unionism
- Collective Bargaining 689**
The Work Agreement/The Bargaining Process
- Economic Effects of Unions 691**
The Union Wage Advantage/Efficiency and Productivity
- Labor Market Discrimination 694**
Types of Discrimination/Costs of Discrimination
- Economic Analysis of Discrimination 696**
Taste-for-Discrimination Model/Statistical Discrimination/Occupational Segregation: The Crowding Model
- Antidiscrimination Policies and Issues 700**
The Affirmative Action Controversy/Recent Developments
- Immigration 702**
Number of Immigrants/Economics of Immigration/Complications and Modifications/Immigration: Two Views
- Last Word: Orchestrating Impartiality 706**
- 36 The Economics of Health Care 710**
- The Health Care Industry 710**
- Twin Problems: Costs and Access 710**
- High and Rising Health Care Costs 711**
Health Care Spending/Quality of Care: Are We Healthier?/Economic Implications of Rising Costs/The Basic Problem
- Limited Access 714**
- Why the Rapid Rise in Costs? 715**
Peculiarities of the Health Care Market/The Increasing Demand for Health Care/Role of Health Insurance/Supply Factors in Rising Health Care Prices/Relative Importance
- Reform of the Health Care System 721**
Universal Access/Cost Containment: Altering Incentives/Recent Laws and Proposals
- Last Word: A Market for Human Organs? 725**

PART NINE

International Economics and the World Economy

- 37 International Trade 730**
- Some Key Facts 730
 - The Economic Basis for Trade 732
 - Comparative Advantage: Graphical Analysis 732
 - Two Isolated Nations/Specializing Based on Comparative Advantage/Terms of Trade/Gains from Trade/Trade with Increasing Costs/The Case for Free Trade*
 - Supply and Demand Analysis of Exports and Imports 737
 - Supply and Demand in the United States/Supply and Demand in Canada/Equilibrium World Price, Exports, and Imports*
 - Trade Barriers 741
 - Economic Impact of Tariffs/Economic Impact of Quotas/Net Costs of Tariffs and Quotas/Impact on Income Distribution*
 - The Case for Protection: A Critical Review 743
 - Military Self-Sufficiency Argument/Increased Domestic Employment Argument/Diversification-for-Stability Argument/Infant Industry Argument/Protection-against-Dumping Argument/Cheap Foreign Labor Argument/A Summing Up*
 - The World Trade Organization 747
 - Last Word: Petition of the Candlemakers, 1845 748

38 Exchange Rates, the Balance of Payments, and Trade Deficits 752

- Financing International Trade 752
 - U.S. Export Transaction/U.S. Import Transaction*
- The Balance of Payments 753
 - Current Account/Capital Account/Official Reserves Account/Payments Deficits and Surpluses*
- Flexible Exchange Rates 756
 - Depreciation and Appreciation/Determinants of Exchange Rates/Flexible Rates and the Balance of Payments/Disadvantages of Flexible Exchange Rates*

- Fixed Exchange Rates 761
 - Use of Reserves/Trade Policies/Exchange Controls and Rationing/Domestic Macroeconomic Adjustments*
- International Exchange-Rate Systems 763
 - The Gold Standard: Fixed Exchange Rates/The Bretton Woods System/The Current System: The Managed Float*
- Recent U.S. Trade Deficits 767
 - Causes of the Trade Deficits/Implications of U.S. Trade Deficits*
- Last Word: Speculation in Currency Markets 769

39 The Economics of Developing Countries 773

- The Rich and the Poor 773
 - Classifications/Comparisons/Growth, Decline, and Income Gaps/The Human Realities*
- Obstacles to Economic Development 776
 - Natural Resources/Human Resources/Capital Accumulation/Technological Advance/Sociocultural and Institutional Factors*
- The Vicious Circle 783
- Role of Government 783
 - A Positive Role/Public Sector Problems*
- Role of Advanced Nations 785
 - Expanding Trade/Foreign Aid: Public Loans and Grants/Flows of Private Capital*
- Where from Here? 788
 - DVC Policies for Promoting Growth /LAC Policies for Fostering DVC Growth*
- Last Word: Famine in Africa 791

WEB BONUS CHAPTER
Transition Economies: Russia and China 1

www.mhhe.com/economics/mcconnell15

- Ideology and Institutions 1
- State Ownership and Central Planning 2
 - Planning Goals and Techniques*
- Problems with Central Planning 4
 - The Coordination Problem/The Incentive Problem*

Collapse of the Soviet Economy 5

*Declining Growth/Poor Product Quality/Lack of
Consumer Goods/Large Military Burden/
Agricultural Drag*

**The Russian Transition to a
Market System 6**

*Privatization/Price Reform/Promotion of
Competition/Making the Ruble Fully Convertible/
Price-Level Stabilization/Other Major Problems/
Future Prospects*

Market Reforms in China 10

*Agricultural and Rural Reform/Reform of Urban
Industries/Special Economic Zones/Development of
Supporting Institutions/Transformation of the SOEs*

Outcomes and Prospects 12

Positive Outcomes of Reform/Problems

Conclusion 13

Last Word: Police Smash Down Smirnov's
Doors 14

Glossary G-1**Index I-1**