

Contents

1	<i>What Is Economics All About, How Do We Use This Book, and Why Is This Book Different from All Other Introductory Economics Textbooks?</i>	1	5	<i>Gross National Product</i>	59
				What Is Gross National Product?	59
				How GNP Is Measured	60
				A. <i>The Expenditures Approach</i>	61
				B. <i>Flow-of-Income Approach</i>	63
				Two Things to Avoid When Compiling GNP	67
				A. <i>Multiple Counting</i>	67
				B. <i>Treatment of Transfer Payments</i>	68
				GNP versus Real GNP	68
				Per Capita Real GNP	72
				Shortcomings of GNP as a Measure of National Economic Well-Being	74
				A. <i>Production That Is Excluded</i>	74
				B. <i>Treatment of Leisure Time</i>	75
				C. <i>Human Costs and Benefits</i>	76
				D. <i>What Goes into GNP?</i>	77
				The Last Word on GNP	78
2	<i>Resource Utilization</i>	3	6	<i>The Consumption Sector</i>	83
	Economics Defined	3		Consumption	83
	The Three Questions of Economics	4		Saving	84
	The Central Fact of Economics: Scarcity	5		Average Propensity to Consume (APC)	84
	<i>Scarcity and the Need to Economize</i>	5		Average Propensity to Save (APS)	85
	<i>The Economic Problem</i>	6		Marginal Propensity to Consume (MPC)	86
	<i>The Four Economic Resources</i>	6		Marginal Propensity to Save (MPS)	87
	<i>Opportunity Lost</i>	7		Graphing the Consumption Function	88
	Full Employment and Full Production	8		The Saving Function	91
	The Production Possibilities Frontier	11		What the Consumer Buys	94
	✓ Economic Growth	13		The Determinants of Consumption	95
	The Law of Diminishing Returns	16		<i>Disposable Income</i>	95
	Chapter 2 Appendix: The Law of Increasing Costs	23		<i>Credit Availability</i>	95
				<i>Stock of Liquid Assets in the Hands of Consumers</i>	96
3	<i>Supply and Demand</i>	29		<i>Stock of Consumer Durables in the Hands of Consumers</i>	96
	Demand	29		<i>Keeping Up with the Joneses</i>	96
	Supply	30		<i>Consumer Expectations</i>	97
	Equilibrium	31		The Permanent Income Hypothesis	97
	Changes in Demand and Supply	33		The Determinants of Saving	98
	<i>Applications of Supply and Demand</i>	34		Why Do We Spend So Much and Save So Little?	99
4	<i>The Mixed Economy</i>	41			
	The Invisible Hand, the Price Mechanism, and Perfect Competition	41			
	<i>The Invisible Hand</i>	42			
	<i>The Price System</i>	43			
	<i>Competition</i>	43			
	The Circular Flow Model	44			
	✓ The Economic Role of Government	46			
	Capital	46			
	Specialization and Its Consequences	48			
	<i>Specialization and Exchange</i>	48			
	<i>Specialization and Alienation</i>	49			
	The "Isms": Capitalism, Fascism, Communism, and Socialism	50			
	<i>The Decline and Fall of the Communist System</i>	52			

7 The Business-Investment Center 105

- Proprietorships, Partnerships, and Corporations 105
- The Proprietorship* 105
- The Partnership* 105
- The Corporation* 106
- Stocks and Bonds* 107
- Investment 107
- Gross Investment versus Net Investment 109
- Building Capital 111
- The Determinants of the Level of Investment 113
 - (1) *The Sales Outlook* 113
 - (2) *Capacity Utilization Rate* 113
 - (3) *The Interest Rate* 114
 - (4) *The Expected Rate of Profit* 114
- Why Do Firms Really Invest?* 116
- What Accounts for Our Low Rate of Investment?* 116
- Graphing the $C + I$ Line 116
- The Summing Up of Investment* 118

8 The Government Sector 123

- Introduction: The Growing Economic Role of Government 123
- Part I: Government Spending 124
 - Federal Government Spending* 124
 - State and Local Government Spending* 127
 - Government Purchases versus Transfer Payments* 128
 - What Do We Want the Government to Do?* 128
- Part II: Taxes 129
 - The Average Tax Rate and the Marginal Tax Rate* 129
 - Types of Taxes* 132
 - Sources of Federal Revenue* 135
 - Sources of State and Local Revenue* 140
 - The State and Local Fiscal Dilemma* 140
 - Comparisons of Taxes in the United States and Other Countries* 141
 - Two Principles of Taxation: Ability to Pay versus Benefits Received* 142
- Part III: The Economic Role of Government 143
 - (1) *Redistribution of Income* 143
 - (2) *Stabilization* 143
 - (3) *Economic Regulation* 144
 - (4) *Conclusion* 145
- Part IV: A Summing Up: $C + I + G + X_n$ 145
- Graphing the $C + I + G$ Line* 145

- Graphing the $C + I + G + X_n$ Line* 146
- Summary of GNP Components* 147

9 Economic Fluctuations, Unemployment, and Inflation 153

- Part I: A Brief History of the American Economy since World War I 153
 - 1920 to 1945 153
 - 1945 to 1970 154
 - 1970 to the Present 155
- Part II: Economic Fluctuations 156
 - Is There a Business Cycle?* 156
 - Cycle Turning Points: Peaks and Troughs* 156
 - The Conventional Three-Phase Business Cycle* 157
 - Business Cycle Theories* 158
 - Endogenous Theories* 158
 - Exogenous Theories* 160
 - Business Cycle Forecasting* 160
 - Analytic Forecasts* 160
 - Barometric Forecasts* 161
 - The GNP Gap* 162
- Part III: Unemployment 163
 - The Problem* 163
 - How the Unemployment Rate Is Computed* 164
 - Types of Unemployment* 167
- Part IV: Inflation 169
 - The Post-World War II History of Inflation* 170
 - The Construction of the Consumer Price Index* 172
 - Anticipated and Unanticipated Inflation* 173
 - Theories of the Causes of Inflation* 175
 - Inflation as a Psychological Process* 177
 - Creeping and Hyperinflation* 177
 - Conclusion* 178

10 Equilibrium GNP: Aggregate Demand Equals Aggregate Supply 185

- Part I: The Classical Economic System 185
 - Supply and Demand Revisited* 187
 - The Classical Equilibrium: Aggregate Demand Equals Aggregate Supply* 189
 - The Aggregate Demand Curve* 189
 - The Long-Run Aggregate Supply Curve* 192
 - The Short-Run Aggregate Supply Curve* 193
- Part II: The Keynesian Critique of the Classical System 195

Part III: The Keynesian System	198	Part II: Banking	257
<i>The Keynesian Aggregate Expenditure Model</i>	198	<i>A Short History of Banking</i>	257
Disequilibrium and Equilibrium	200	<i>The Federal Deposit Insurance Corporation</i>	261
(1) <i>Aggregate Demand Exceeds Aggregate Supply</i>	200	<i>The Savings and Loan Debacle</i>	262
(2) <i>Aggregate Supply Exceeds Aggregate Demand</i>	201	<i>Branch Banking and Bank Chartering</i>	264
(3) <i>Summary: How Equilibrium Is Attained</i>	201	<i>The Creation and Destruction of Money</i>	265
Keynesian Policy Prescriptions	202	<i>The Creation of Money</i>	265
		<i>The Destruction of Money</i>	266
		<i>Limits to Deposit Creation</i>	266
11 Fiscal Policy and the National Debt	209	13 The Federal Reserve and Monetary Policy	273
Putting Fiscal Policy into Perspective	209	<i>The Federal Reserve System</i>	273
Part I: The Deflationary Gap and the Inflationary Gap	210	<i>The Federal Reserve District Banks</i>	274
<i>The Deflationary Gap</i>	210	<i>The Board of Governors</i>	274
<i>The Inflationary Gap</i>	211	<i>Independence of the Board of Governors</i>	275
Part II: The Multiplier and Its Applications	212	<i>Legal Reserve Requirements</i>	275
<i>The Multiplier</i>	212	<i>Primary and Secondary Reserves</i>	277
<i>Applications of the Multiplier</i>	214	✓ <i>Deposit Expansion</i>	277
Part III: The Deficit Dilemma	217	<i>How Deposit Expansion Works</i>	277
✓ <i>Deficits, Surpluses, and the National Budget</i>	218	<i>The Deposit Expansion Multiplier</i>	278
<i>Deficits and Surpluses: The Record</i>	218	<i>Three Modifications of the Deposit Expansion Multiplier</i>	279
<i>Why Are Large Deficits So Bad?</i>	220	✓ <i>The Tools of Monetary Policy</i>	281
<i>Will We Ever Be Able to Balance the Budget?</i>	221	<i>How Open-Market Operations Work</i>	281
Part IV: Fiscal Policy	222	<i>The Federal Open-Market Committee</i>	281
✓ <i>The Automatic Stabilizers</i>	222	<i>Discount Rate Changes</i>	284
<i>Discretionary Fiscal Policy</i>	226	<i>Changing Reserve Requirements</i>	285
<i>The Proposed Balanced Budget Amendment</i>	228	<i>Summary: The Tools of Monetary Policy</i>	285
<i>The Full-Employment Budget</i>	229	<i>The Fed's Effectiveness in Fighting Inflation and Recession</i>	286
<i>The Crowding-Out and Crowding-In Effects</i>	230	<i>The Depository Institutions Deregulation and Monetary Control Act of 1980</i>	286
<i>Concluding Word on Fiscal Policy</i>	232	<i>Fiscal and Monetary Policies Should Mesh</i>	289
✓ Part V: The Public Debt	232		
12 Money and Banking	241	14 Twentieth-Century Economic Theory	295
Part I: Money	241	<i>Classical Economics</i>	295
✓ <i>The Three Jobs of Money</i>	241	<i>Keynesian Economics</i>	297
<i>Our Money Supply</i>	243	<i>The Monetarist School</i>	299
✓ <i>M1, M2, and M3</i>	244	<i>The Importance of the Rate of Monetary Growth</i>	299
<i>Our Growing Money Supply</i>	246	<i>The Basic Propositions of Monetarism</i>	300
<i>The Equation of Exchange</i>	247	<i>The Monetary Rule</i>	302
✓ <i>The Quantity Theory of Money</i>	248	<i>The Decline of Monetarism</i>	302
<i>The Demand for Money</i>	250	<i>Supply-Side Economics</i>	303
<i>The Demand Schedule for Money</i>	253	<i>The Work Effect</i>	303
✓ <i>The Liquidity Trap</i>	254		
✓ <i>Determination of the Interest Rate</i>	254		

<i>The Saving and Investment Effect</i>	303	<i>The Economic Growth of the United States</i>	340
<i>The Elimination of Productive Market Exchanges</i>	304	<i>Why Is Our Productivity Increasing So Slowly?</i>	342
✓ <i>The Laffer Curve</i>	304	<i>Our Low Savings Rate</i>	343
Rational Expectations Theory	306	<i>Our Low Rate of Investment</i>	346
Conclusion	308	<i>The Declining Quality and Quantity of Labor</i>	347
Chapter 14 Appendix: The Great Debate: The Keynesians versus the Monetarists	315	<i>Other Factors Affecting Our Rate of Growth</i>	350
Preliminary Debate	315	✓ <i>Economic Growth in the Less Developed Countries</i>	352
Round One: How Stable Is V?	315		
<i>Velocity and Changes in the Money Supply</i>	315		
<i>How Stable Is Velocity in the Short Run?</i>	316		
Round Two: The Transmission Mechanism	318	17 Demand 361	
<i>Introduction</i>	318	<i>Demand Defined</i>	361
<i>The Keynesian View</i>	319	<i>Individual Demand and Market Demand</i>	361
<i>The Monetarist View</i>	320	<i>Changes in Demand</i>	362
<i>Comparison of Keynesian and Monetarist Transmission Mechanisms</i>	321	<i>What Causes Changes in Demand?</i>	367
<i>Who Is Right?</i>	321	✓ <i>The Elasticity of Demand</i>	368
Round Three: Monetary Policy	322	<i>Elasticity</i>	371
<i>Fighting Recessions</i>	322	<i>The Meaning of Elasticity</i>	371
<i>Fighting Inflations</i>	323	✓ <i>Elasticity and Total Revenue</i>	377
Round Four: A Question of Timing	324	<i>Determinants of the Degree of Elasticity of Demand</i>	378
✓ <i>The Lags</i>	324	<i>Advertising</i>	380
<i>Fiscal Policy Lags</i>	324	✓ <i>Utility</i>	381
<i>Monetary Policy Lags</i>	325	<i>What Is Utility?</i>	381
<i>Fiscal versus Monetary Policy: A Summing Up</i>	326	<i>Marginal Utility</i>	381
		<i>Total Utility</i>	382
		<i>Maximizing Utility</i>	382
15 A Guide to Macropolicy 331		<i>Getting Your Priorities Straight at Burger King: A Summary of Utility</i>	383
<i>Fighting Recessions</i>	331	<i>Consumer Surplus</i>	385
<i>Conventional Fiscal Policy</i>	331		
<i>Conventional Monetary Policy</i>	331		
<i>Two Policy Dilemmas</i>	332		
<i>Fighting Inflation</i>	332	18 Supply 393	
<i>Conventional Fiscal Policy</i>	332	<i>Supply Defined</i>	393
<i>Conventional Monetary Policy</i>	332	<i>Individual Supply and Market Supply</i>	394
<i>Fighting Inflationary Recessions: Two More Policy Dilemmas</i>	332	<i>Changes in Supply</i>	394
<i>Incomes Policies: An Alternate Approach</i>	333	<i>Elasticity of Supply</i>	397
<i>Wage and Price Controls</i>	333	<i>Costs</i>	398
<i>Tax-Based Incomes Policies</i>	333	<i>Fixed Costs</i>	398
<i>Attaining a Satisfactory Rate of Economic Growth</i>	334	<i>Variable Costs</i>	399
<i>The Limits of Macropolicy</i>	334	<i>Total Cost</i>	399
Conclusion	335	<i>Marginal Cost</i>	400
		<i>The Short Run</i>	400
16 Economic Growth and Productivity 339		<i>The Long Run</i>	401
<i>The Industrial Revolution and American Economic Development</i>	339	<i>The Shutdown Decision</i>	401
		Chapter 18 Appendix: Ceilings, Floors, and Tax Burdens	408
		<i>Price Ceilings and Price Floors</i>	408
		<i>Tax Incidence</i>	410

19 Supply in the Short Run and the Long Run 415

- Average Cost 415
- Average Fixed Cost 415
- Average Variable Cost 416
- Average Total Cost 417
- Graphing the AFC, AVC, ATC, and MC Curves 418
- Revenue and Profit 421
- Total Revenue and Marginal Revenue 421
- Profit Maximization and Loss Minimization 423
- The Short-Run and Long-Run Supply Curves 429
- Derivation of Firm's Short-Run Supply Curve 429
- A Summing Up 431
- The Long-Run Planning Envelope Curve 433
- The Market Supply 437

20 Perfect Competition 443

- Definition of Perfect Competition 443
- The Perfect Competitor's Demand Curve 444
- The Short Run 446
- The Long Run 449
- Economic and Accounting Profits 451
- Efficiency 452
- Decreasing, Constant, and Increasing Cost Industries 452
- Decreasing Costs and the Breakdown of Perfect Competition 453

21 Monopoly 459

- Monopoly Defined 459
- The Graph of the Monopolist 459
- Calculating the Monopolist's Profit 462
- Review of the Monopolist's Economic Analysis 465
- The Monopolist in the Short Run and the Long Run 467
- Demand and Supply under Monopoly 468
- Barriers to Entry 468
- Limits to Monopoly Power 470
- Economies of Scale and Natural Monopoly 471
- Why Is Bigness Bad? 472
- Two Policy Alternatives 474
- Conclusion 475

22 Monopolistic Competition 481

- Monopolistic Competition Defined 481

- The Monopolistic Competitor in the Short Run 481
- The Monopolistic Competitor in the Long Run 484
- Product Differentiation 485
- The Typical Monopolistic Competitor 485
- Price Discrimination 486
- Is the Monopolistic Competitor Inefficient? 488

23 Oligopoly 495

- Oligopoly Defined 495
- Concentration Ratios 496
- The Competitive Spectrum 497
- Oligopoly without Collusion: The Kinked Demand Curve 502
- Administered Prices 509

24 Corporate Mergers and Antitrust 515

- A Historical Perspective on Corporate Concentration 515
- Antitrust 516
- The Political Background 516
- The Sherman Antitrust Act 516
- The Clayton Act 518
- The Federal Trade Commission Act (1914) 519
- Modern Antitrust 519
- Partial Breakdown of the Rule of Reason 519
- The 60 Percent Rule 520
- The Celler-Kefauver Antimerger Act 520
- Types of Mergers 520
- Horizontal Mergers 520
- Vertical Mergers 521
- Conglomerate Mergers 522
- Recent Mergers 523
- How Effective Is Antitrust? 523
- The Trend toward Bigness 524

25 The Four Types of Competition: A Review 533

- Perfect Competition 533
- Monopoly 535
- Monopolistic Competition 535
- Oligopoly 537
- Summary Tables 538

26 Demand in the Factor Market 545

- Derived Demand 545
- Productivity 546
- Prices of Substitute Resources 546
- Marginal Revenue Product 547

Graphing the MRP	550	The Net Productivity of Capital	603
The MRP of the Imperfect Competitor	552	The Capitalization of Assets	604
Changes in Resource Demand	555	The Present Value of Future Income	606
Changes in Resource Demand versus Changes in Quantity of Resource Demanded	555	Profits	607
The Four Reasons for Changes in Resource Demand	556	How Are Profits Determined?	607
Optimum Resource Mix for the Firm	559	How Large Are Profits?	608
		Theories of Profit	608
		Conclusion	610
27 Unions, Labor Markets, and Wage Rates 565		29 Income Distribution and Poverty 617	
A Short History of the American Labor Movement	566	Part I: Income Distribution in the United States	617
The Early Years	566	The Poor, the Middle Class, and the Rich	617
Key Labor Legislation	567	Distribution of Wealth in the United States	620
The Labor Movement since the New Deal	569	Distribution of Income: Equity and Efficiency	622
The Economic Power of the Labor Unions	571	What Determines Income Distribution?	623
The Economic Power of Large Employers	572	Differences in Wages and Salaries	624
Collective Bargaining	573	Property Income	626
The Collective Bargaining Agreement	575	Income from Government Transfer Payments	626
The Strike	576	Part II: Poverty in America	627
Have Unions Raised Wages?	578	Poverty Defined	627
The Supply of Labor	578	Who Are the Poor?	629
Noncompeting Groups	578	The Main Government Transfer Programs	632
The Theory of the Dual Labor Market	579	Theories of the Causes of Poverty	633
The Backward-Bending Supply Curve	579	The Poor Are Lazy	633
The Demand for Labor	581	The Heritage of Slavery	634
The Marginal Revenue Product Schedule	581	Employment Discrimination	634
Nonhomogeneous Jobs	583	Black Male Joblessness	634
Graph of the Demand for Labor	584	Poverty Breeds Poverty	635
The Wage Rate: Supply and Demand	584	Inadequate Human Capital	636
High Wage Rates and Economic Rent	585	The Conservative Theory of Poverty	636
Real Wages and Productivity	586	The Liberal Theory of Poverty	637
Should There Be a Minimum Wage Rate?	587	Solutions	637
		The Negative Income Tax	637
28 Rent, Interest, and Profits 597		The Conservative Solution	640
Rent	597	Workfare	640
What Is Land?	597	Conclusion	641
How Is Rent Determined?	598	30 International Trade 647	
Economic Rent	600	Part I: The Theory of International Trade	648
Are Prices High Because Rents Are High, or Are Rents High Because Prices Are High?	601	Specialization and Trade	648
Interest	602	Domestic Exchange Equations	649
What Is Capital?	602	The Terms of Trade	650
How Is the Interest Rate Determined?	602	Absolute Advantage and Comparative Advantage	652
Determination of the Level of Investment	602	The Arguments for Protection	655
		Tariffs or Quotas	658

Conclusion 659
 Part II: The Practice of International Trade 660
Our Imbalance of Trade 660
What Are the Causes of Our Trade Imbalance? 660
What Can We Do? 665

31 *International Finance* 673

✓ Part I: The Mechanics of International Finance 673
 ✓ *Financing International Trade* 674
 ✓ *The Balance of Payments* 674
 ✓ *Exchange Rate Systems* 676
 ✓ *The Gold Exchange Standard, 1944-1973* 677

How Do Freely Floating (Flexible) Exchange Rates Work? 680
 Part II: The Decline and Fall of the American Economy 681
From Largest Creditor to Largest Debtor 681
 Warning: Do Not Read beyond This Point If You Think This Book Has a Happy Ending 684
Living beyond Our Means 684
 Closing Word: Will Foreigners Soon Own America? 685 *jasne*

Glossary 691
Index 697