

# Preface

This edition has the same purpose as its predecessors, namely, to combine economic theory and application in an up-to-date, accessible, and appealing way. When I first decided to write *Understanding Economics, A Contemporary Perspective*, my aim was to use my years of undergraduate teaching to write a text that could engage first-year students and help them realize the power of economic theory in explaining the practical aspects of their lives. I hope this new edition is as successful as the first two in accomplishing this goal.

## What's New in the Third Edition?

The favourable reception of the previous editions led several instructors and students to make valuable criticisms and suggestions for change. I have incorporated many of these suggestions in this new edition. For example, material on the aggregate expenditures model has been divided into two separate appendices, at the end of Chapter 11 and Chapter 12. The first introduces the aggregate expenditures model. The second includes the government sector. This makes it easier for instructors who wish to introduce the model without covering the detailed mechanics involved in incorporating government purchases and taxes. And greater use is made of the Online Learning Centre ([www.mcgrawhill.ca/lovelwell](http://www.mcgrawhill.ca/lovelwell)) that accompanies this book to provide an extended treatment of important economic issues. This online material is written in a style closely allied with the text, making it possible to move seamlessly from one to the other.


These changes have been made without expanding the book's size—a common problem with third editions. Indeed, this new edition is shorter than the second, by 20 pages. This has been achieved by reducing the number of sideline articles dealing with optional theoretical topics such as indifference curves (accompanying Chapter 2) and applied subjects such as the evolution of money (Chapter 13). These articles now appear in the Online Learning Centre. Also, material appearing in the previous edition that was ignored by the vast majority of users has been deleted.

The book's organization is comparable with that of the second edition, with several notable exceptions. The sidelines that accompany Chapter 2 (indifference curves), Chapter 4 (measuring business performance), Chapter 6 (the OPEC cartel), Chapter 7 (labour unions), Chapter 13 (the evolution of money), Chapter 14 (details of current Canadian monetary policy), and Chapter 15 (international finance in Canada) now appear in the Online Learning Centre. Material on the aggregate expenditures model has been divided into two separate appendices, accompanying Chapter 11 and Chapter 12, and Chapter 7 has been shortened.

## Specific Changes in the Third Edition

The introductory material at the start of each chapter has been revised to provide a consistent focus on major topics. The sections entitled **Thinking about Economics** appearing in each chapter are now accompanied not just by questions to provoke student thinking and discussion (for example, see Chapter 3, page 53, Chapter 5, page 110,

Chapter 7, page 167), but answers to these questions have been added to the Online Learning Centre.

<b>THINKING ABOUT ECONOMICS</b>  Do “new economy” industries exhibit entry barriers?	<p>Some important markets in the new economy are oligopolies or even monopolies, which suggests the existence of entry barriers. These barriers can take distinctive forms. For example, the network effect refers to the fact that some information products (for example, software and telecommunications services) become more valuable when they are used by many people. Similarly, the lock-in effect refers to the reluctance consumers have buying a new information product (such as a particular brand of software) once they have already invested the time in learning a similar program. In new economy industries, these new types of entry barriers often appear alongside more traditional barriers, such as increasing returns to scale.</p> <p style="text-align: right;">   <a href="http://www.liberate.com">http://www.liberate.com</a>  <a href="http://www.ctca.ca/">http://www.ctca.ca/</a> </p>
<p><b>Question</b>          What are some examples of new economy industries in which network and lock-in effects have helped create oligopolies or monopolies?</p>	

Also, given the importance of hands-on work, Practice Questions have been added following each Brief Review. For example, see Chapter 1, page 19.

<b>Brief Review</b>	<ol style="list-style-type: none"> <li>1. Three basic economic questions must be answered by every country: what to produce, how to produce, and for whom to produce.</li> <li>2. Traditional economies stress the role of custom and tradition. Market economies rely on private property and the operation of markets. Command economies depend on publicly owned property and central planning.</li> <li>3. Modern mixed economies combine features of both market and command economies in different degrees. Traditional mixed economies include both traditional and modern sectors.</li> <li>4. The main goals of the Canadian economy are economic efficiency, income equity, price stability, full employment, a viable balance of payments, economic growth, and environmental sustainability. Some of these goals are complementary, while others are conflicting.</li> </ol>
<b>1.4 Practice Questions</b>	<p>Countries Alpha and Beta each have traditional, private, and public sectors. The traditional and public sectors each make up a larger proportion of Alpha's economy than their proportions in Beta. On the other hand, the private sector is relatively larger in Beta than in Alpha.</p> <ol style="list-style-type: none"> <li>a. Which country will tend to have more economic freedom?</li> <li>b. Which country's economy will tend to have greater stability?</li> <li>c. In which country will there be the greatest conflict between traditional culture and national planners?</li> <li>d. If the two countries' systems are plotted in the triangle shown in Figure 1.4, will Alpha be northwest, southwest, northeast, or southeast of Beta?</li> </ol>

Answers to these Practice Questions appear at the Lovewell Online Learning Centre, [www.mcgrawhill.ca/college/lovewell](http://www.mcgrawhill.ca/college/lovewell).

Specific chapter-by-chapter changes include:

## Part 1

Chapter 1 includes a more detailed description of opportunity cost and its interpretation

The optional Sideline on indifference curves accompanying Chapter 2 has been moved to the Online Learning Centre.

Chapter 3 includes a more detailed description of the mathematical derivation of the numerical value of price elasticities.

## Part 2

The optional Sideline on measuring business performance accompanying Chapter 4 has been moved to the Online Learning Centre.

Chapter 5 includes a more detailed description of the profit-maximizing rule and its interpretation.

The optional Sideline on the OPEC cartel accompanying Chapter 6 has been moved to the Online Learning Centre.

Chapter 7's discussion of resource demand for businesses in imperfectly competitive product markets has been moved to the Online Learning Centre. The optional

Sideline on labour unions accompanying this chapter has been moved to the Online Learning Centre.

### Part 3

The discussions of the calculation of real GDP in Chapters 9 and 10 have been updated in line with recent reporting changes by Statistics Canada.

Chapter 11 now includes an appendix that deals with the basic aggregate expenditures model.

Chapter 12's appendix now deals with the extension of the aggregate expenditures model to include government.

The optional Sideline on the evolution of money accompanying Chapter 13 has been moved to the Online Learning Centre.

Chapter 14's treatment of Canadian monetary policy tools has been streamlined in line with new Bank of Canada procedures. The optional Sideline on details of current monetary policy in Canada in this chapter has been moved to the Online Learning Centre.

### Part 4

Chapter 15's treatment of the balance of payments accounts has been amended to conform to recent reporting changes by Statistics Canada. The optional Sideline on international finance in Canada accompanying this chapter has been moved to the Online Learning Centre.

The Advancing Economic Thought article on John F. Helliwell accompanying Chapter 16 has been shortened.

## Current Issues

As did its predecessors, this edition also explores important current issues. After all, economics is part of daily life—in the choices we make, in the decisions of communities, governments, and businesses, and in the media. While developing the theoretical framework of economics, *Understanding Economics* offers real-world examples and explores current economic issues. Articles, essays, and interviews stimulate critical thinking, research, application, and more. By providing a balanced and wide range of perspectives, these elements encourage students to evaluate and debate economic issues for themselves.

The **Sideline** articles, both in the book and at the book's Online Learning Centre, deal with a wide range of economic issues—for example, the debate over the Bank of Canada's zero-inflation policy, and the increasing significance of cross-border financial flows.

CHAPTER 12 Fiscal Policy 307

### Mountain or Mirage

#### The Debate over Public Debt

At first sight, the figures are astounding. From 1982, when public debt was under \$5000 per Canadian, by 2001 the federal government's debt rose to about \$17 200 per capita. And supplementing this 2001 figure is another amount over \$7600 that each Canadian owes because of the debts of the provincial and territorial governments—making a total of almost \$25 000 a head. Is public debt too high? Are the potential costs of this debt exaggerated by those who want less government involvement in the economy? Or does the truth lie somewhere in-between? Because the costs are great, whatever the truth—huge debt at one extreme, potentially reduced government programs at the other—this is a question not only for economists and policy-makers but also for the public as a whole. Let us take a look at the opposing perceptions.

number's significance. They argue that when interest is paid on Canadian-owned public debt, funds are simply taken from one group of Canadians in the form of taxes or new borrowing and given to another group of Canadians. In other words, the total "economic pie" does not get bigger or smaller—just the sizes of the slices.

**Assets versus Liabilities** When debt is used to create productive assets, it can be defended in the same way as the debt acquired by businesses for investment purposes. While Canadian government investment in capital goods—at least as defined in the national accounts—has fallen in recent decades as a percentage of GDP, supporters of fiscal policy suggest that the problem lies in the definitions. They believe that we should define productive assets more widely to include the country's human resources, whose worth is promoted through such expenditures as education. Unfortunately, it is difficult to put a value on a country's stock of productive assets when they are broadly defined in this way.

**Comparisons with the Past** Because of substantial inflation and economic growth over the debt trap.

SIDELINE

Within each chapter, **Advancing Economic Thought** details the ideas of an influential thinker of the past or the present and allows students to judge their contemporary relevance. So, for example, Adam Smith’s defence of private markets, Karl Marx’s theory of capitalist exploitation, and Thomas Malthus’s treatment of population growth are featured, as well as David Foot’s treatment of demographic change, Paul Romer’s innovative view of economic growth, and Nuala Beck’s analysis of the “new economy.”

CHAPTER 10 Inflation and Unemployment 243

### BOOM, BUST & ECHO


David K. Foot and the Economics of Age Distribution

*What economic indicators can we apply to our personal lives? David K. Foot, a well-known Canadian economist and demographer, suggests that our ages can give us insights into our economic futures. In the following excerpt from his book Boom, Bust & Echo, 2000 (written with Daniel Stoffman), Foot outlines some of the effects of Canada’s huge “baby-boom generation” (people born from 1947 to 1966), its smaller “baby-bust generation” (people born from 1967 to 1979), and its “baby-boom echo generation” (people born from 1980 to 1995).*

Demography, the study of human populations, is the most powerful—and most underutilized—tool we have to understand the past and to foretell the future. Demographics affect every one of us as individuals, far more than most of us have ever imagined. They also play a pivotal role in the economic and social life of our country.

What kinds of foods will people buy, and what kinds of cars will they drive? Where will they choose to live? Which investments will they favour? These and many other things can be confidently predicted, simply on the basis of readily available data on the age of Canadians. The two keys to these forecasts are the number of people in each age group and the probability that each person will participate in a given behaviour.

Canada’s population pyramid (see Figure A) contains a massive bulge, representing the huge generation of baby-boomers born in the 20 years from 1947 to 1966. By comparison, the Depression and World War II generations that preceded the baby boom are small, as is the baby bust that followed it. But the most recently arrived group, the offspring of the boomers—or the baby-boom echo—is comparatively large.



**David Foot**  
Source: Footwork Consulting Inc.  
Photographer: D’Arcy Ghosna

**ADVANCING ECONOMIC THOUGHT**

In addition, each chapter includes several points for discussion called **Thinking about Economics**—many with a contemporary focus on new technologies and the Internet—which help students interpret and apply the concepts they are learning through a question-and-answer format.

## Emphasis on Skills

Application is the key to effective learning. So that students have ample opportunity to apply the knowledge they acquire, this text emphasizes skills throughout. As an initial review and a resource to return to for direction and hints, the **Skills Resource** focuses on the basics of critical thinking, the use of economic language and visual materials, research, and ways of presenting findings. For example, this resource guides students in evaluating their own work or that of others to see that it is precise, logical, and considered; it reviews interpreting and creating tables and graphs; it illustrates economic forecasting; it lists possible resources; it discusses the use of the Internet as a research tool; and it supports essay-writing and debating.

## Skills Resource

*Understanding Economics* requires that you interpret, analyze, and apply information. Use this general resource first to review the skills you will need and then—as you venture further into *Understanding Economics*—for direction and helpful hints.

### The Basics of Critical Thinking

Information, ideas, and opinions abound. Whether you are interpreting and analyzing the work of others or developing your own observations, opinions, and arguments, you must use critical thinking skills. Critical thinking involves precise meaning, logic, and consideration of values and perspectives. Evaluate your work and that of others against these basics.

#### PRECISE MEANING

The rule “Say what you mean and mean what you say” can be applied to all subjects and topics. Keep in mind these questions: What don’t I understand? Can I paraphrase this? What really is the point? What might confuse the audience? Where is the meaning clear? Where is it murky?

*See that you are using terminology precisely or define terms in their writing.*

In the body of each chapter, issues relating to the use of **Economics as a second language** are highlighted.

#### Marginal Cost

"Marginal" has a different interpretation when referring to cost rather than product. While marginal product is defined in terms of each new unit of labour, with cost, the focus switches to new units of output instead.

Questions appear at the end of each chapter, as well as at the end of all supplementary articles. **Policy discussion questions** (at the end of most chapters) deal with practical issues in the application of economic thinking to day-to-day politics. Selected **Internet Application Questions** provide practice in using economics-related resources on the Internet.

## Study Aids

To make *Understanding Economics* inviting and engaging for students, care has been taken to present the text in a clear and readable style and to use an appealing design. At the same time, a variety of features make this text user-friendly. Every chapter begins with **Learning Objectives**, which introduce the content students are to learn and which are reinforced with an icon throughout the body of the text where concepts are covered.

#### LEARNING OBJECTIVES

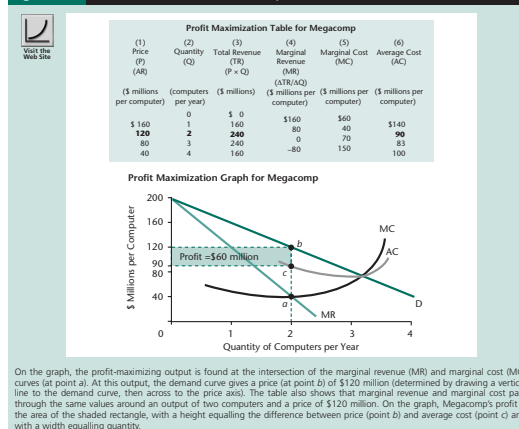
In this chapter, you will:

- 1 learn about the price elasticity of demand, its relation to other demand elasticities, and its impact on sellers' revenues
- 2 learn about the price elasticity of supply and the links between production periods and supply
- 3 consider how governments use price controls to override the "invisible hand" of competition
- 4 examine spillover costs and benefits and the ways that government addresses these issues

LO 11.1

Then, each **Brief Review** summarizes key ideas, while margin notes define key terms highlighted in the text. These terms are listed at the end of each chapter under the heading **Key Concepts** for review and are defined again in a consolidated **Glossary** at the end of the book for easy reference. Following each Brief Review are **Practice Questions** whose answers appear in the Online Learning Centre. Because interpreting graphs is a challenge for many students, virtually all graphs are paired with tables so that it is possible to see at a glance how they are plotted. This technique not only makes graphs easier to interpret but also helps students appreciate the usefulness of visual aids in presenting economic information. Lastly, an **Index** helps students access the text in a variety of ways.

Figure 6.6 Profit Maximization for a Monopolist





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## FOR THE STUDENTS

**Study Guide** ISBN: 007-092316-7 written by Brenda Gayle-Anyiwe, Seneca College and Mark Lovewell, Ryerson University. This guide, written in conjunction with the text, gives students the opportunity to test their knowledge of text material with questions and answers, as well as helpful hints and summaries, tied to each chapter.



**Student Online Learning Centre** located at [www.mcgrawhill.ca/college/lovewell](http://www.mcgrawhill.ca/college/lovewell), offers a wealth of materials, including quizzes, Interactive Graphing Exercises (graphs that can be manipulated to solve exercises like those in the textbook), Internet Application Questions, answers to the text's Practice Questions, answers to the questions following each Thinking About Economics discussion point, Sideline articles, annotated Web links and much more!



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