

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 three in accomplishing this goal.

What's New in the Fourth 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 has been added to Chapter 3 on the connection between elasticity and excise taxes. This makes it easier for instructors who wish to deal in greater depth with the incidence of excise taxes before this topic is re-introduced in the discussion of spillover effects. In Chapter 6, material has been added on game theory—including a new Advancing Economic Thought article on Thomas Schelling. This allows instructors to deal in greater depth with the variety of theoretical approaches that exist to analyze oligopolistic markets. In Chapter 7, material has been added on welfare economics, allowing instructors to deal with new associated topics such as producer surplus and deadweight loss.

These changes have been made without expanding the book's size—a common problem with fourth editions. Indeed, this new edition is shorter than the third. Material appearing in the previous edition that was ignored by the vast majority of users has been deleted. This has been achieved by reducing discussions of the operation of resource markets (condensed and moved to an appendix at the end of Chapter 5), wages and their determinants (condensed and moved to the body of Chapter 7), income distribution (no longer a separate chapter, but now condensed and moved to the body of Chapter 7), the theory of economic growth and its application to Canada (condensed and moved to the body of Chapter 10), and the discussion of economic development (moved to the Online Learning Centre).

The book's organization is comparable with that of the third edition, with several notable exceptions.

Specific Changes in the Fourth Edition

There are two fewer chapters than before, with an appendix in Chapter 5 in this edition incorporating a condensed discussion of the operation of resource markets, which was previously the main focus of a separate chapter. Chapter 7 incorporates material that was previously interspersed in various chapters, and Chapter 10 incorporates a condensed discussion of economic growth that was previously the focus of a separate chapter.

Key graphs throughout the text—such as Figures 4.7 and 14.1—have been enlarged to increase their ease of use for readers.

Specific chapter-by-chapter changes include:

Part 1

Chapter 1's discussion of traditional economies has been extended, as has its discussion of the moral and political underpinnings of economic goals.

Chapter 2's explanation of the cause of a price change resulting from a shortage has been expanded.

Chapter 3's discussion of the benefits and costs of rent controls has been extended. The chapter no longer includes a discussion of spillover effects (moved to Chapter 7). Instead, it incorporates a new discussion of the incidence of excise taxes. The material in the chapter's former *Advancing Economic Thought* article on Alfred Marshall has been moved to Chapter 7. It has been replaced by the article on Karl Marx and the labour theory of value, which previously accompanied Chapter 5.

Part 2

Chapter 4's description of the derivation of the long-run average cost curve from a range of short-run average cost curves has been extended and new material has been added on identifying the horizontal coordinates of points on the marginal cost curve. Additional numerical questions have been added at the end of the chapter, and the discussion of corporate bankruptcies in the *Advancing Economic Thought* article on John Kenneth Galbraith has been updated.

Chapter 5 is accompanied by a new appendix summarizing the operation of resource markets, which was previously part of a separate chapter. Its *Advancing Economic Thought* article is now on Joseph Schumpeter, moved from Chapter 6.

Chapter 6 incorporates new material on game theory, as well as a new *Advancing Economic Thought* article on Thomas Schelling.

Chapter 7 incorporates material previously found in various chapters—discussions of spillover effects, consumer surplus, wages and their determinants, and income distribution—as well as new material on welfare economics, including a discussion of producer surplus and deadweight loss. The discussion of income distribution has been expanded with a treatment of the Gini coefficient.

Part 3

Chapter 10 now incorporates material on economic growth in Canada, which was previously part of a separate chapter. New questions have been added to the chapter appendix.

New questions have also been added to the appendix of Chapter 11.

New material has been added to Chapter 13 on the Bank of Canada's inflation targets, and a new question at the end of the chapter deals with the Bank's definition of core inflation.

Part 4

The material on the relationship between the balances on Canada's current account and its capital and financial accounts in Chapter 14 has been updated, and new questions dealing with the capital and financial accounts have been added to the end of the chapter.

At several points in Chapter 15, the discussion has been updated to take account of the heightened roles being played by China and India in global trade. Finally, the article on Nuala Beck and the New Economy that accompanied the final chapter (Chapter 17) in the previous edition has been moved to the end of Chapter 15, and the article on John F. Helliwell and globalization that it replaces has been moved to the Online Learning Centre.

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.

Sideline

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PART 1 Working with Economics

For the Public Good

The Economic Role of Government

So far, we have looked at some of the ways government intervenes in private markets. But in mixed economies, such as Canada's, government also has an independent economic role. In Canada, this role is a relatively recent creation. Before the 1930s, federal and provincial governments maintained the legal system and provided education up to the secondary school level. But health care and universities were left largely in the hands of the private sector, and unemploy-

because of layoffs, temporary sickness, or the birth or adoption of a child. Finally, the Quebec and Canada Pension Plans (QPP and CPP) provide workers in Quebec and the rest of Canada with payments after retirement, financed by compulsory contributions from employees and their employers.

Other Spending Programs
Provincial and territorial governments finance the costs of health care, provide subsidies for post-secondary education that translate into reduced tuition fees for students, and (with the help of municipalities) offer welfare services to single-parent families with low incomes, individuals who are unable to find work due to disabilities,

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."

THE GAMES PEOPLE PLAY


Thomas C. Schelling and Game Theory

Schelling and His Influence
Thomas C. Schelling, an emeritus professor at the University of Maryland, is best known for his contributions to game theory, which won him, as well as Israeli mathematician Robert Aumann, the Nobel Prize in Economics in 2005. After studying economics at the University of California at Berkeley and then at Harvard, Schelling carved out an academic career first at Yale and then at Harvard, while also involved with government and research institutes.

This was a time when game theory was still relatively new and largely confined to the mathematical sphere, thanks to its creators, mathematicians John von Neumann and Oskar Morgenstern as well as others, such as John Nash, subject of the Academy Award-winning movie *A Beautiful Mind*. Schelling transformed game theory by concerning himself less with mathematical details, and more with the nuances of human perception and interaction. In doing so, he helped ensure that game theory became an integral part of economic thinking – not just in the analysis of oligopolistic behaviour, but wherever strategic game-playing occurs.

The Case of Military Strategy

ADVANCING
ECONOMIC
THOUGHT



Thomas C. Schelling

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.

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

CAPITAL RESOURCES

In economics, the term **capital resources**, or capital, refers to the real assets of an economy—the processed materials, equipment, and buildings that are used in production. An example is a newspaper printing plant and its printing presses, as well as the processed inputs—paper and ink—used to make newspapers. Therefore, the term “capital” has a special meaning in economics. As economic resources, capital resources do not include financial capital, such as stocks and bonds. A person’s shares in Bombardier, for example, do not add to the economy’s stock of real capital. Similarly, the bonds issued by a company, such as Bell Canada, are viewed as financial capital by their holders, but not as real capital by economists.

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

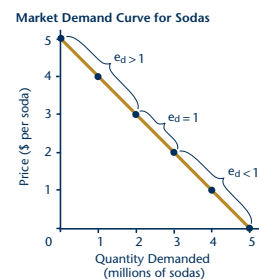
In this chapter, you will:

- 1 consider the nature of demand, changes in quantity demanded, changes in demand, and the factors that affect demand
- 2 examine the nature of supply, changes in quantity supplied, changes in supply, and the factors that affect supply
- 3 see how markets reach equilibrium—the point at which demand and supply meet

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 3.6 Elasticity and a Linear Demand Curve

Market Demand Schedule for Sodas		
Price (\$ per soda)	Quantity Demanded (millions of sodas)	Price Elasticity of Demand (e_d)
5	0	9.00
4	1	2.33
3	2	1.00
2	3	0.43
1	4	0.11
0	5	0.11



The slope of this linear demand curve is always -1 millionth. But at any price range above \$3, this linear demand curve is elastic, with a price elasticity (e_d) greater than 1. Between prices \$3 and \$2, the curve is unit-elastic, given an e_d equal to 1. Finally, at any price range below \$2, the curve is inelastic, and e_d is less than 1.

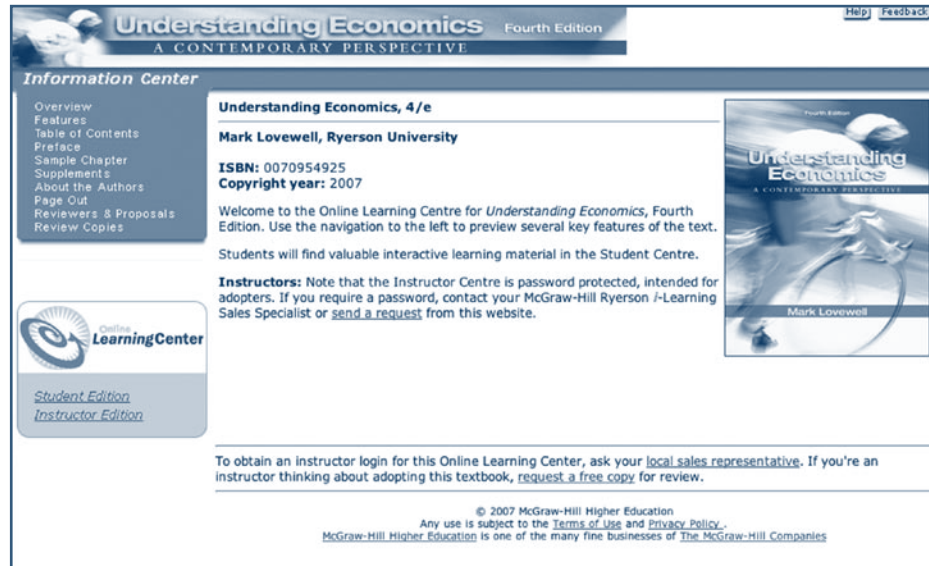
Technology Solutions

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Ancillaries

FOR THE INSTRUCTOR

Instructor's Online Learning Centre

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FOR THE STUDENTS

iStudy written by Brenda Gayle-Anyiwe, Seneca College. Open 24 hours a day so you can study when you want, how you want, and where you want.

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Student Online Learning Centre See Technology Solutions on page xvi.



Σ-STAT is Statistics Canada's education resource that allows you to view socioeconomic and demographic data in charts, graphs, and maps. Access to **Σ-STAT** and the CANSIM II database is made available from this web site by special agreement between McGraw-Hill Ryerson and Statistics Canada to purchasers of the Lovewell textbook. Please visit the Online Learning Centre for additional information.

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