

Contents

Preface	xvii	Optimal Allocation	16
PART 1: An Introduction to Economics and the Economy	1	1.8 Unemployment, Growth, and the Future	17
CHAPTER 1: Limits, Alternatives, and Choices	2	A Growing Economy	17
1.1 Ten Key Concepts to Retain for a Lifetime	3	<i>Consider This—Women, the Workforce, and Production Possibilities</i>	19
The Individual	3	Present Choices and Future Possibilities	20
Interaction Among Individuals	3	A Qualification: International Trade	21
The Economy as a Whole and the Standard of Living	3	<i>The Last Word—Pitfalls to Sound Objective Thinking</i>	21
1.2 The Economic Way of Thinking	4	Chapter Summary	22
Scarcity and Choice	4	Terms and Concepts	23
Purposeful Behaviour	4	Study Questions	24
<i>Consider This—Free for All?</i>	5	Internet Application Questions	25
Marginal Analysis: Benefits and Costs	5	Appendix to Chapter 1	26
<i>Consider This—Fast Food Lines</i>	6	A1.1 Graphs and Their Meaning	26
1.3 Theories, Principles, and Models	6	Construction of a Graph	26
1.4 Macroeconomics and Microeconomics	7	Direct and Inverse Relationships	27
Macroeconomics	7	Dependent and Independent Variables	27
Microeconomics	8	Other Things Equal	28
Positive and Normative Economics	8	Slope of a Line	29
1.5 The Individual's Economic Problem	9	Vertical Intercept	30
Limited Income	9	Equation of a Linear Relationship	30
Unlimited Wants	9	Slope of a Nonlinear Curve	31
A Budget Line	10	Appendix Summary	31
1.6 Society's Economic Problem	12	Appendix Terms and Concepts	32
Scarce Resources	12	Appendix Study Questions	32
Resource Categories	12	CHAPTER 2: The Market System and the Circular Flow	34
1.7 The Production Possibilities Model	13	2.1 Economic Systems	35
The Production Possibilities Table	13	The Command System	35
The Production Possibilities Curve	14	The Market System	35
The Law of Increasing Opportunity Cost	14	2.2 Characteristics of the Market System	36
		Private Property	36

Freedom of Enterprise and Choice	36	Market Demand	59
Self-Interest	37	Change in Demand	59
Competition	37	Changes in Quantity Demanded	63
Markets and Prices	38	3.2 Supply	64
Technology and Capital Goods	38	Law of Supply	64
Specialization	39	The Supply Curve	64
Use of Money	39	Market Supply	64
Active, but Limited, Government	40	Determinants of Supply	65
2.3 Five Fundamental Questions	41	Changes in Supply	65
What Will Be Produced?	41	3.3 Market Equilibrium	68
<i>Consider This—McHits and McMisses</i>	42	Equilibrium Price and Quantity	68
How Will the Goods and Services Be Produced?	42	<i>Consider This—Ticket Scalping: A Bum Rap!</i>	70
Who Will Get the Output?	43	Rationing Function of Prices	71
How Will the System Accommodate Change?	43	Efficient Allocation	71
How Will the System Promote Progress?	44	Changes in Supply, Demand, and Equilibrium	71
The “Invisible Hand”	45	<i>Consider This—Salsa and Coffee Beans</i>	73
2.4 The Demise of the Command Systems	45	3.4 Application: Government-Set Prices	74
The Coordination Problem	45	Price Ceilings on Gasoline	74
The Incentive Problem	46	Price Floors on Wheat	76
2.5 Market Failure	46	<i>The Last Word—A Legal Market for Human Organs?</i>	78
Externalities	47	Chapter Summary	79
Public Goods and Services	48	Terms and Concepts	79
Limitations of the Market System	49	Study Questions	80
<i>Consider This—Market Failure and the Need for Government</i>	49	Internet Application Questions	81
2.6 The Circular Flow Model	50	Math Appendix to Chapter 3	82
Factor Market	50	A3.1 The Mathematics of Market Equilibrium	82
Product Market	50	The Demand Curve	82
<i>The Last Word—Shuffling the Deck</i>	52	The Supply Curve	83
Chapter Summary	53	The Market Equilibrium	83
Terms and Concepts	54	Example	84
Study Questions	54	Part 2:	
Internet Application Questions	55	Microeconomics of Product Markets	85
CHAPTER 3:		CHAPTER 4:	
Demand, Supply, and Market Equilibrium	56	Extensions of Demand and Supply Analysis and the Efficiency of Markets	86
3.1 Demand	57	4.1 Price Elasticity of Demand	87
Law of Demand	57		
The Demand Curve	59		

The Price Elasticity Coefficient and Formula	87	Total Utility and Marginal Utility	118
Interpretation of E_d	89	Marginal Utility and Demand	120
4.2 The Total Revenue Test	89	<i>Consider This—Vending Machines and Diminishing Marginal Utility</i>	120
Elastic Demand	90	5.2 The Theory of Consumer Choice	121
Inelastic Demand	91	Consumer Choice and Budget Constraint	121
Unit Elasticity	91	Utility-Maximizing Rule	121
Price Elasticity along a Linear Demand Curve	92	Numerical Example	122
Price Elasticity and the Total-Revenue Curve	92	Algebraic Restatement	124
Determinants of Price Elasticity of Demand	93	5.3 Utility Maximization and the Demand Curve	124
Applications of Price Elasticity of Demand	95	Deriving the Demand Schedule and Curve	124
4.3 Price Elasticity of Supply	97	Income and Substitution Effects	125
Price Elasticity of Supply: The Market Period	97	5.4 Applications and Extensions	126
Price Elasticity of Supply: The Short Run	98	DVDs and DVD Players	126
Price Elasticity of Supply: The Long Run	98	The Diamond–Water Paradox	127
Applications of Price Elasticity of Supply	98	The Value of Time	127
4.4 Cross Elasticity and Income Elasticity of Demand	99	Cash and Noncash Gifts	128
Cross Elasticity of Demand	99	<i>The Last Word—Criminal Behaviour</i>	129
Income Elasticity of Demand	100	Chapter Summary	130
4.5 Elasticity and Real-World Applications	101	Terms and Concepts	130
Elasticity and Tax Incidence	101	Study Questions	130
<i>Consider This—Below-Equilibrium Prices</i>	104	Internet Application Questions	132
The Economics of Agricultural Price Supports	104	Appendix to Chapter 5	133
4.6 Consumer and Producer Surplus	106	A5.1 Indifference Curve Analysis	133
Consumer Surplus	107	The Budget Line: What Is Attainable	133
Producer Surplus	108	Indifference Curves: What Is Preferred	134
Efficiency Revisited	109	The Indifference Map	136
Efficiency Losses (or Deadweight Losses)	110	Equilibrium at Tangency	136
<i>The Last Word—Elasticity and Pricing Power: Why Different Consumers Pay Different Prices</i>	112	The Measurement of Utility	137
Chapter Summary	113	The Derivation of the Demand Curve	137
Terms and Concepts	114	<i>Consider This—Indifference Maps and Topographical Maps</i>	138
Study Questions	114	Income and Substitution Effects	138
Internet Application Questions	115	Appendix Summary	141
Chapter 5:		Appendix Terms and Concepts	141
Consumer Choice and Utility Maximization	117	Appendix Study Questions	141
5.1 The Law of Diminishing Marginal Utility	118		
Terminology	118		

Chapter 6:			
The Organization and Costs of Production	142		
6.1 The Firm and the Business Sector	143		
Legal Forms of Businesses	143		
Advantages of Corporations	143		
<i>Consider This—Unprincipled Agents</i>	144		
The Principal–Agent Problem	145		
6.2 Economic Costs	145		
Explicit and Implicit Costs	146		
Normal Profit as a Cost	146		
Economic Profit	147		
Short Run and Long Run	147		
6.3 Short-Run Production Relationships	148		
Law of Diminishing Returns	149		
<i>Consider This—Diminishing Returns from Study</i>	149		
6.4 Short-Run Production Costs	151		
Fixed, Variable, and Total Costs	153		
Per-Unit, or Average, Costs	155		
Marginal Cost	156		
Shifts of Cost Curves	159		
6.5 Long-Run Production Costs	160		
Firm Size and Costs	160		
The Long-Run Cost Curve	160		
Economies and Diseconomies of Scale	161		
Minimum Efficient Scale and Industry Structure	165		
Applications and Illustrations	166		
<i>The Last Word—Don't Cry over Sunk Costs</i>	167		
Chapter Summary	168		
Terms and Concepts	169		
Study Questions	169		
Internet Application Questions	171		
Chapter 7:			
Perfect Competition	172		
7.1 Four Market Structures	173		
7.2 Characteristics of Perfect Competition and the Firm's Demand Curve	173		
Demand for a Firm in Perfect Competition	174		
Average, Total, and Marginal Revenue	175		
7.3 Profit-Maximization in the Short Run: Total-Revenue–Total-Cost Approach	177		
Profit Maximization in the Short-Run: Marginal-Revenue–Marginal-Cost Approach	179		
<i>Consider This—The Still There Motel</i>	182		
7.4 Marginal Cost and Short-Run Supply	184		
Generalized Depiction	184		
Diminishing Returns, Production Costs, and Product Supply	186		
Supply Curve Shifts	186		
Firm and Industry: Equilibrium Price	186		
7.5 Profit Maximization in the Long Run	188		
Assumptions	189		
The Goal of Our Analysis	189		
Long-Run Equilibrium	189		
Long-Run Supply for a Constant-Cost Industry	191		
Long-Run Supply for an Increasing-Cost Industry	191		
Long-Run Supply for a Decreasing-Cost Industry	192		
7.6 Perfect Competition and Efficiency	193		
Productive Efficiency: $P = \text{Minimum ATC}$	193		
Allocative Efficiency: $P = MC$	195		
Maximum Consumer and Producer Surplus	195		
Dynamic Adjustments	196		
"Invisible Hand" Revisited	196		
<i>The Last Word—Efficiency Gains from Entry: The Case of Generic Drugs</i>	197		
Chapter Summary	198		
Terms and Concepts	198		
Study Questions	199		
Internet Application Questions	200		
Chapter 8:			
Monopoly	201		
8.1 Characteristics of Monopoly	202		
Examples of Monopoly	202		
Dual Objectives of the Study of Monopoly	202		
Barriers to Entry	202		

Monopoly Demand	205	9.2 Price and Output in Monopolistic Competition	230
8.2 Output and Price Determination	208	The Firm's Demand Curve	230
Cost Data	208	The Short Run: Profit or Loss	232
MR=MC Rule	208	The Long Run: Only a Normal Profit	232
No Monopoly Supply Curve	210	Monopolistic Competition and Efficiency	233
Misconceptions About Monopoly Pricing	210	Benefits of Product Variety	234
Possibility of Losses by Monopolist	211	Further Complexity	234
8.3 Economic Effects of Monopoly	212	9.3 The Characteristics of Oligopoly	235
Price, Output, and Efficiency	212	A Few Large Producers	235
Income Transfer	213	Homogeneous or Differentiated Products	235
Cost Complications	213	Control over Price, but Mutual Interdependence	236
Assessment and Policy Options	216	Entry Barriers	236
8.4 Price Discrimination and Monopoly	217	Mergers	236
Conditions	217	Measures of Industry Concentration	236
Examples of Price Discrimination	217	9.4 Oligopoly Pricing Behaviour: A Game Theory Overview	238
Graphical Analysis	218	Basic Concepts	238
<i>Consider This—Price Discrimination at the Ballpark</i>	219	Prisoner's Dilemma	239
8.5 Regulated Monopoly	220	Strategies in a Two-Firm Oligopoly	240
Socially Optimal Price: $P=MC$	220	Mutual Interdependence Revisited	241
Fair-Return Price: $P=ATC$	221	Collusive Tendencies	241
Dilemma of Regulation	221	Incentive to Cheat	242
8.6 Monopoly and Deadweight Loss	221	9.5 Two Oligopoly Strategies: The Incentives and Obstacles to Collusion	242
<i>The Last Word—De Beers' Diamonds: Are Monopolies Forever?</i>	223	<i>Consider This—Creative Strategic Behaviour</i>	243
Chapter Summary	224	Cartels and Other Collusion: Cooperative Strategies	243
Terms and Concepts	224	Price Leadership Model: Another Cooperative Strategy	246
Study Questions	224	9.6 Oligopoly and Advertising	247
Internet Application Question	226	Positive Effects of Advertising	247
Chapter 9:		Potential Negative Effects of Advertising	248
Monopolistic Competition and Oligopoly	227	Oligopoly and Efficiency	248
9.1 Characteristics of Monopolistic Competition	228	<i>The Last Word—Oligopoly in the Beer Industry</i>	250
Relatively Large Number of Sellers	228	Chapter Summary	251
Differentiated Products	228	Terms and Concepts	252
Easy Entry and Exit	229	Study Questions	252
Advertising	229	Internet Application Question	253
Monopolistically Competitive Industries	229		

Chapter 10:			
Competition Policy and Regulation	254		
10.1 Industrial Concentration	255		
Competition Policy	255		
Competition Law	256		
Merger Guidelines: The Herfindhal Index	256		
<i>Consider This—Cast Iron Pipes and Market Power in Canada</i>	257		
10.2 Industrial Regulation	259		
Natural Monopoly	259		
Problems with Industrial Regulation	259		
Legal Cartel Theory	260		
Deregulation	261		
10.3 Social Regulation	261		
Distinguishing Features	262		
The Optimal Level of Social Regulation	262		
Criticisms of Social Regulation	263		
Two Reminders	263		
<i>Consider This—Canada and the Kyoto Accord</i>	264		
<i>The Last Word—The United States versus Microsoft</i>	265		
Chapter Summary	266		
Terms and Concepts	267		
Study Questions	267		
Internet Application Question	268		
Part 3:			
Microeconomics of Factor Markets	269		
Chapter 11:			
The Demand for Factors of Production	270		
11.1 Factor Pricing and Demand	271		
Marginal Productivity Theory of Factor Demand	271		
<i>Consider This—She’s the One</i>	276		
11.2 Determinants for Factor Demand	277		
Changes in Product Demand	277		
Changes in Productivity	277		
Changes in the Prices of Other Factors	277		
11.3 Elasticity of Factor Demand	279		
Ease of Factor Substitutability	280		
Elasticity of Product Demand	280		
Ratio of Factor Cost to Total Cost	280		
11.4 Optimal Combination of Factors	281		
The Least-Cost Rule	281		
The Profit-Maximizing Rule	282		
Numerical Illustration	282		
Marginal Productivity Theory of Income Distribution	284		
<i>The Last Word—Input Substitution: The Case of ABMs</i>	285		
Chapter Summary	286		
Terms and Concepts	286		
Study Questions	287		
Internet Application Questions	288		
Chapter 12:			
Wage Determination	289		
12.1 Productivity and the General Level of Wages	290		
The Role of Productivity	290		
Real Wages and Productivity	291		
Growth of Real Wages	292		
12.2 Wages in a Perfectly Competitive Labour Market	292		
Market Demand for Labour	293		
Market Supply of Labour	293		
Labour Market Equilibrium	293		
12.3 Monopsony Model	295		
Upward-Sloping Labour Supply to a Firm	296		
MFC Higher than the Wage Rate	296		
Equilibrium Wage and Employment	297		
Examples of Monopsony Power	297		
12.4 Unions and the Labour Market: Three Models	298		
Demand-Enhancement Model	298		
Exclusive or Craft Union Model	299		
Inclusive or Industrial Union Model	300		
Wage Increases and Unemployment	301		

Bilateral Monopoly Model	302	Sources of Economic Profit	324
12.5 The Minimum Wage	303	Functions of Profit	325
Case against the Minimum Wage	303	13.4 Income Shares	327
Case for the Minimum Wage	303	<i>The Last Word—Determining the Price of Credit</i>	327
Evidence and Conclusions	304	Chapter Summary	328
12.6 Wage Differentials	304	Terms and Concepts	329
Marginal Revenue Productivity	304	Study Questions	329
Noncompeting Groups	305	Internet Application Question	330
Compensating Differences	306	Chapter 14:	
<i>Consider This—My Entire Life</i>	307	Income Inequality, Poverty, and Discrimination	331
Market Imperfections	307	14.1 Facts about Income Inequality	332
12.7 Pay for Performance and the Principal-Agent Problem	308	Distribution by Income Category	332
The Principal-Agent Problem Revisited	309	Distribution of Personal Income by Quintiles (Fifths)	332
Addendum: The Negative Side Effects of Pay for Performance	310	The Lorenz Curve	332
<i>The Last Word—Are Top Executives in Canada Overpaid?</i>	311	Income Mobility: The Time Dimension	334
Chapter Summary	312	Effect of Government Redistribution	334
Terms and Concepts	312	14.2 Causes of Income Inequality	334
Study Questions	313	Ability	335
Internet Application Question	313	Education and Training	335
Chapter 13:		Discrimination	335
Rent, Interest, and Profit	314	Preferences and Risks	335
13.1 Economic Rent	315	Unequal Distribution of Wealth	335
Perfectly Inelastic Supply	315	Market Power	336
Changes in Demand	316	Luck, Connections, and Misfortune	336
Land Rent: A Surplus Payment	316	Trends in Income Inequality	336
Productivity Differences and Rent Differences	316	14.3 Equality versus Efficiency	338
Alternative Uses of Land	317	The Case for Equality: Maximizing Total Utility	338
13.2 Interest: The Price of Money	317	The Case for Inequality: Incentives and Efficiency	339
<i>Consider This—That Is Interest</i>	318	<i>Consider This—Slicing the Pizza</i>	340
Loanable Funds Theory of Interest	318	The Equality-Efficiency Tradeoff	340
Extending the Model	319	14.4 Poverty: Measurement and Incidence	340
Range of Interest Rates	321	Definition of Poverty	340
Pure Rate of Interest	321	Who Are the Poor?	341
Role of the Interest Rate	321	Measurement Issues	342
13.3 Economic Profit	323	The Income Maintenance System	342
Role of the Entrepreneur	323	14.5 Welfare Policy: Goals and Conflicts	343

Common Features	343	<i>Consider This</i> —“Lemons”	370
Conflicts among Goals	344	Inadequate Information about Buyers	370
14.6 Labour Market Discrimination	344	Qualification	372
Types of Discrimination	345	15.4 The Economics of Health Care	372
Costs of Discrimination	345	Peculiarities of the Health Care Market	372
<i>Consider This</i> —Gender Discrimination	346	Third Party Payments: Insurance	373
<i>The Last Word</i> —Poverty in the Voices of Poor People	349	Possible Solutions to Excess Demand	374
Chapter Summary	350	<i>The Last Word</i> —Lojack: A Case of Positive Externalities	375
Terms and Concepts	350	Chapter Summary	376
Study Questions	351	Terms and Concepts	377
Internet Application Question	352	Study Questions	377
		Internet Application Question	378
Part 4:		Chapter 16:	
Microeconomics of Government and International Economics	353	Public Choice Theory and the Economics of Taxation	379
Chapter 15:		16.1 Revealing Preferences through Majority Voting	380
Government and Market Failure	354	Inefficient Voting Outcomes	380
15.1 Public Goods	355	Interest Groups and Logrolling	381
Private Goods Characteristics	355	Paradox of Voting	382
Public Goods Characteristics	355	Median-Voter Model	383
<i>Consider This</i> —Art for Art’s Sake	356	16.2 Government Failure	384
Optimal Quantity of a Public Good	356	Special Interests and Rent Seeking	384
Demand for Public Goods	356	Clear Benefits, Hidden Costs	385
Comparing MB and MC	357	Limited and Bundled Choice	385
Cost–Benefit Analysis	357	Bureaucracy and Inefficiency	386
15.2 Externalities	360	Imperfect Institutions	386
Negative Externalities	360	16.3 Apportioning the Tax Burden	387
Positive Externalities	360	Benefits Received versus Ability to Pay	387
Individual Bargaining: Coase Theorem	361	Progressive, Proportional, and Regressive Taxes	388
Liability Rules and Lawsuits	362	16.4 Tax Incidence and Efficiency Loss	389
Government Intervention	362	Elasticity and Tax Incidence	389
A Market-Based Approach to Negative Externalities	364	Efficiency Loss of a Tax	391
Society’s Optimal Amount of Externality Reduction	366	Probable Incidence of Taxes in Canada	393
Global Warming	367	Recent Canadian Tax Reform	396
15.3 Information Failures	369	<i>The Last Word</i> —Rent Seeking	397
Inadequate Information about Sellers	369	Chapter Summary	398
		Terms and Concepts	398

Study Questions	398	Diversification for Stability Argument	417
Internet Application Question	399	<i>Consider This—Shooting Yourself in the Foot</i>	417
Chapter 17:		Infant-Industry Argument	418
International Trade	400	Protection against Dumping Argument	418
17.1 The Economic Basis for Trade	401	Increased Domestic Employment Argument	419
Specialization and Comparative Advantage	401	Cheap Foreign Labour Argument	419
The Basic Principle	402	Trade Adjustment Assistance	420
Two Isolated Nations	402	Offshoring	420
Specialization Based on Comparative Advantage	404	<i>The Last Word—The WTO Protests</i>	422
Terms of Trade	404	Chapter Summary	423
Gains from Specialization and Trade	405	Terms and Concepts	423
Trade with Increasing Costs	407	Study Questions	423
The Case for Free Trade Restated	408	Internet Application Questions	425
17.2 Supply and Demand Analysis of Exports and Imports	409	Credits	426
Supply and Demand in Canada	409	Glossary	427
Supply and Demand in the United States	411	Index	438
Equilibrium World Price, Exports, and Imports	412	Web Site Bonus Chapters (found at www.mcgrawhill.ca/olc/mcconnell)	
17.3 Trade Barriers	413	Chapter 13W:	
Economic Impact of Tariffs	414	Natural Resource and Energy Economics	
Economic Impact of Quotas	416	Chapter 16W:	
Net Costs of Tariffs and Quotas	416	Canadian Agriculture: Economics and Policy	
17.4 The Case for Protection: A Critical Review	416		
Self-Sufficiency Argument	417		