



# PREFACE



**T**he first European edition of *Microeconomics and Behaviour* builds on the well-established book by Robert H. Frank. The goal remains to produce an intellectually challenging text that is also accessible and engaging to students. The more common approach in this market has been to emphasize one of these dimensions or the other. For example, some texts have done well by sacrificing rigour in the name of user-friendliness. But although such books sometimes keep students happy, they often fail to prepare them for more advanced economics courses. Other texts have succeeded by sacrificing accessibility in the name of rigour, where rigour all too often means little more than mathematical density. These courses overwhelm many undergraduates, and even those few who become adept at solving well-posed mathematical optimization problems are often baffled by questions drawn from everyday contexts. Our approach is based on a strong belief that a text could at once be rigorous and user-friendly. And to judge by the breadth of *Microeconomics and Behaviour's* adoption list, many of you apparently agree.

This book was written with the conviction that the teaching of intuition and the teaching of technical tools are complements, not substitutes. Students who learn only technical tools rarely seem to develop any real affection for our discipline; and even more rarely do they acquire that distinctive mind-set we call 'thinking like an economist'. By contrast, students who develop economic intuition are stimulated to think more deeply about the technical tools they learn, and to find more interesting ways to apply them. Most important, they usually end up liking economics.

*Microeconomics and Behaviour* develops the core analytical tools with patience and attention to detail. At the same time, it embeds these tools in a uniquely diverse collection of examples and applications to illuminate the power and versatility of the economic way of thinking.

## ECONOMIC NATURALISM

There is no more effective device for developing intuition than to become 'economic naturalists'. Studying biology, chemistry or physics enables people to observe and marvel at many details of life that would otherwise have escaped notice. In much the same way, studying microeconomics can enable students to see the mundane details of ordinary existence in a sharp new light. Throughout the text, we try to develop intuition by means of examples and applications drawn from everyday experience. *Microeconomics and Behaviour* teaches students to see each feature of the manmade landscape as the reflection of an implicit or explicit cost-benefit calculation.

To illustrate, an economic naturalist is someone who wonders why the business manager of the economics department was delighted when lecture notes for a course were put on the university's intranet server, whereas the very same move troubled the associate dean in the management school. About a week into the term, there was an urgent letter from this dean saying that henceforth hard copies of lecture notes should be produced for distribution to students free of charge. No similar instruction came from the business manager of the economics department. On seeking clarification, the management school's dean said that students had been

downloading notes and printing them in the school's computer labs at a cost of 5 cents a page, which was far more than the 1.25 cents the school's copy centre was charging at the time. Fair enough. But then why was the economics department's administrator not worried about the same problem? (When asked whether he wanted hard copies of the notes distributed, he replied 'Don't you dare!')

Their different viewpoints, it soon became clear, had nothing to do with the very different cultures of the two units. Instead, they stemmed from a small but important difference in economic incentives: in the management school, the same administrator pays for printing in both the computer labs and the copy centre. The economics department administrator, however, pays only for printing on the department copier. When economics students print lecture notes off the Web in the various campus computer laboratories in the Arts College, the bills go directly to the College. From the economics department's point of view, these copies were free.

We believe that the most valuable assignments on a microeconomics course are ones that ask students to report on their efforts to become economic naturalists. The specific charge is to use microeconomic principles to answer a question prompted by a personal observation. In recent terms, students have grappled with questions like these: Why do the keypads of drive-up ATM machines have Braille dots? Why do top female models earn more than top male models? Why do brides spend so much money on wedding dresses, while grooms often rent cheap tuxedos (even though grooms could potentially wear their tuxedos on many other occasions and brides will never wear their dresses again)? Why are child safety seats required in cars but not for air travel? Why do airlines charge their highest prices to passengers who buy at the last minute, while the practice is exactly the reverse for Broadway theatres?

The beauty of this assignment is not only that most students enjoy writing these papers, but also that few manage to complete them without becoming life-long economic naturalists. For those who would like to learn more about the assignment, a lecture on it is posted in the Authors@google series here: [www.youtube.com/watch?v=QalNVxeIKKE](http://www.youtube.com/watch?v=QalNVxeIKKE).

## FOCUS ON PROBLEM SOLVING

Most economists agree that a critical step in learning price theory is to solve problems. More than any other text currently available in the marketplace, *Microeconomics and Behaviour* prepares students for its end-of-chapter problems by taking them through a sequence of carefully crafted examples and exercises within each chapter. Because most of these examples and exercises are drawn from familiar contexts, and because students engage more readily with the concrete than with the abstract, this approach has proven effectiveness. In the absence of such groundwork, many students would reach the end-of-chapter problems with little or no idea how to proceed.

## OPTIMAL TOPIC COVERAGE

A guiding principle in the evolution of *Microeconomics and Behaviour* has been that topics should be emphasized in proportion both to their importance and to the difficulty that students have in mastering them. Because the basic rational



choice model is the building block for much of what comes later in the course, we have devoted considerably more attention to its development than competing texts do. We have also allocated extra space for elasticity and its applications in demand theory, and for the average-marginal distinction in production theory.

As an additional means for discovering which topics are most difficult to master, we have used research in behavioural economics that identifies systematic departures from the prescriptions of the rational choice model. For example, whereas the model says that rational persons will ignore sunk costs, many people are in fact strongly influenced by them. (Someone who receives an expensive, but painfully tight, pair of shoes as a gift is much less likely to wear them than is someone who spent €400 out of his own pocket for those same shoes.) Especially in the chapters on consumer behaviour, we call students' attention to situations in which they themselves are likely to make irrational choices. Because student resources are limited, it makes sense to focus on precisely those issues for which knowing price theory is most likely to be helpful.

It may seem natural to wonder whether discussing examples of irrational choices might confuse students who are struggling to master the details of the rational choice model. It is a reasonable question, but our experience has been exactly to the contrary. Such examples actually underscore the normative message of the traditional theory. Students who are exposed to them invariably gain a deeper understanding of the basic theoretical principles at issue. Indeed, they often seem to take an almost conspiratorial pride in being able to see through the errors of judgement that many consumers make. For instructors who want to pursue how cognitive limitations affect consumer behaviour in greater detail, there is an entire chapter devoted to this topic. When the first edition of *Microeconomics and Behaviour* appeared in 1991, many in the economics profession were sceptical about the emerging field of behavioural economics. But as evidenced by UC Berkeley economist Matthew Rabin's receipt of the John Bates Clark Award in 2000 (the honour bestowed every two years by the American Economics Association on the most outstanding American economist under the age of 40) and by Daniel Kahneman's receipt of the Nobel Prize in Economics in 2002, the behavioural approach is now part of the microeconomics mainstream.

## A BROADER CONCEPTION OF SELF-INTEREST

Another goal has been to incorporate a broader conception of preferences into models of individual choice. Most texts mention at the outset that the rational choice model takes people's tastes as given. They may be altruists, sadists or masochists; or they may be concerned solely with advancing their narrow material interests. But having said that, most texts then proceed to ignore all motives other than narrow self-interest. It is easy to see why, because economic research has scored its most impressive gains on the strength of this portrayal of human motivation. It tells us, for example, why Ford discontinued production of its Excursion SUV in the wake of petrol price increases; and why thermostats are generally set lower in apartments that have separately metered utilities.

And yet, as students are keenly aware, our *Homo economicus* caricature is patently at odds with much of what we know about human behaviour. People vote in elections. They give anonymously to private charities. They donate bone marrow to strangers with leukaemia. They endure great trouble and expense to



see justice done, even when it will not undo the original injury. At great risk to themselves, they pull people from burning buildings, and jump into icy rivers to rescue people who are about to drown. Soldiers throw their bodies atop live grenades to save their comrades. Seen through the lens of the self-interest theory emphasized in most textbooks, such behaviour is the human equivalent of planets travelling in square orbits. Indeed, many students are strongly alienated by our self-interest model, which they perceive as narrow and mean-spirited.

*Microeconomics and Behaviour* freely concedes the importance of the self-interest motive in many contexts. But it also devotes an entire chapter to the role of unselfish motives in social and economic transactions. Employing elementary game theory, this chapter identifies circumstances in which people who hold such motives have a competitive advantage over pure opportunists. It shows, for example, that people known to have cooperative predispositions can often solve prisoner's dilemmas and other commitment problems in ways that purely self-interested persons cannot.

Our theoretical models of human nature are important, not least because they mould our expectations about how others will behave. Economics is the social science most closely identified with the self-interest model of human behaviour. Does this model colour our expectations of others, and perhaps even our own behaviour? Cornell psychologists Tom Gilovich and Dennis Regan and Robert Frank investigated this question, and found numerous indications that economists are much more likely than others to behave opportunistically in social dilemmas.<sup>1</sup> For example, academic economists were more than twice as likely as the members of any other discipline we surveyed to report that they give no money at all to any private charity. In an experiment, we also found that economics students were more than twice as likely as other students to defect when playing one-shot prisoner's dilemmas with strangers.

This difference was not merely a reflection of the fact that people who chose to do economics were more opportunistic to begin with. It was found, for example, that the difference in defection rates grew larger the longer a student had studied economics. Questionnaire responses also indicated that students in their first microeconomics course were more likely at the end of the term to expect opportunistic behaviour from others than they were at the beginning.

There are thus at least some grounds for concern that, by stressing only the narrow self-interest motive, economists may have undermined our students' propensities for cooperative behaviour. The irony, as we attempt to show in Chapter 7, is that the internal logic of the economic model never predicted such narrowly self-interested behaviour in the first place.

## ADDITIONAL PEDAGOGICAL FEATURES

Unlike most intermediate texts, *Microeconomics and Behaviour* contains no boxed applications, which tend to distract students from the thread of argument being developed. Instead, applications and examples are integrated fully into the text. Many of these have the added advantage of being drawn from experiences to which students can personally relate.

<sup>1</sup>See R. H. Frank, T. D. Gilovich and D. T. Regan, 'Does Studying Economics Inhibit Cooperation?' *Journal of Economic Perspectives*, Spring 1993.

The chapter introductions and summaries are another innovative feature of *Microeconomics and Behaviour*. Most chapters begin with an anecdote that poses a problem or question that the material developed in the chapter will enable the student to answer. These introductions have proved especially helpful for the many students who find that getting started is often the hardest step. The chapter summaries in most current texts consist of brief annotated lists of the topics covered. The chapter summaries in *Microeconomics and Behaviour*, by contrast, are written in a narrative form that carefully synthesizes the material covered in the chapters.

Each chapter concludes with a selection of problems that range in difficulty from routine to highly challenging. These problems have all been class-tested to assure their accuracy and effectiveness in helping students master the most important concepts in the chapters.

Answers to all in-text exercises appear at the end of the chapter in which they occur. Variations and extensions of these exercises are echoed in the end-of-chapter problems, which enables students to approach these problem sets with greater confidence. Detailed answers to all end-of-chapter problems are included in the instructor's manual.

Evidence suggests that introductory economics courses leave little measurable trace on the students who take them. Six months after having taken them, for example, students score no better on tests that probe their knowledge of basic economic principles than others who never took the course at all. In the 2007 book *The Economic Naturalist*, Robert argued that this dismal performance owes largely to the fact that the typical introductory course tries to expose students to far too many ideas and concepts, so that, by term's end, everything seems to have gone by in a blur. These courses would be much more effective if they focused instead on repeated applications of the short list of basic principles that do most of the heavy lifting in economics.

We lack the necessary studies to assess definitively whether intermediate economics courses are ineffective in similar ways. But when teaching microeconomics to first-year PhD students in economics it is clear that a remarkably high proportion of them seem to have developed little economic intuition from their exposure to economics courses as undergraduates. One of the reasons for writing the first edition of this book in 1991 was Robert's conviction that we need to focus more intensively on repeated application of core ideas in the intermediate course. In keeping with that approach in this first European edition, we have tried in each chapter to extract a small number of central insights for succinct summary in the margins.

As the name suggests, this European edition also draws heavily on examples from Europe. The principles of microeconomics are the same the world over. European experiences of microeconomics can, however, be very different to those in North America. In the US, for example, any attempt to increase state involvement in the provision of health care typically attracts vehement hostility. In Europe it is likely to be the opposite, with any attempt to increase private involvement attracting vehement hostility. The examples in this edition are tailored towards a European audience. This also includes recognizing the wide differences that exist within Europe.