

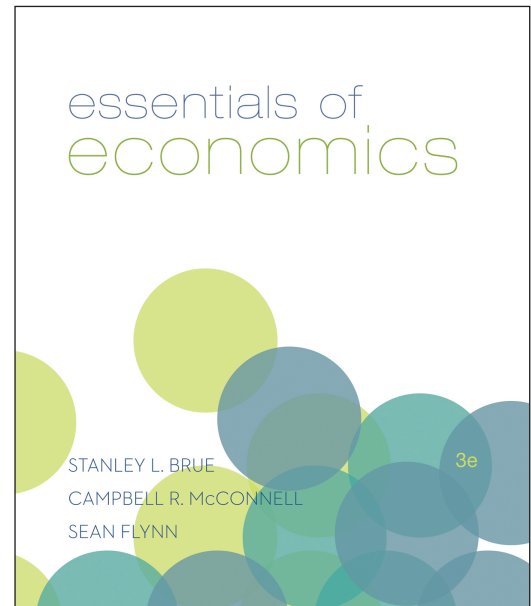
Preface

Welcome to the third edition of *Essentials of Economics*, a one-semester principles of economics text derived from McConnell-Brue-Flynn *Economics*, the best-selling two-semester economics textbook. Over the years numerous instructors have requested a short, one-semester version of *Economics* that would cover both microeconomics and macroeconomics. While some other two-semester books simply eliminate chapters, renumber those that remain, and offer the “cut and splice” version as a customized book, this methodology does not fit with our vision of a tightly focused, highly integrated book. We built this text from scratch, incorporating the core content from *Economics* in a format designed specifically for the one-semester course. This book has the clear and careful language and the balanced approach that has made its two-semester counterpart a best-seller, but the pedagogy and topic discussion are much better suited to the needs of the one-semester course.

We think *Essentials of Economics* will fit nicely in various one-term courses. It is sufficiently lively and focused for use in principles courses populated primarily by nonbusiness majors. Also, it is suitably analytical and comprehensive for use in combined micro and macro principles courses for business and potential economics majors. Finally, we think this book—if supplemented with appropriate lecture and reading assignments—will work well in refresher courses for students returning to MBA programs.

However the book is used, our goals remain the same:

- Help the student master the principles essential for understanding the economic problem, specific economic issues, and policy alternatives.
- Help the student understand and apply the economic perspective and reason accurately and objectively about economic matters.
- Promote a lasting student interest in economics and the economy.



What's New and Improved?

One of the benefits of writing a successful text is the opportunity to revise—to delete the outdated and install the new, to rewrite misleading or ambiguous statements, to introduce more relevant illustrations, to improve the organizational structure, and to enhance the learning aids. We trust that you will agree that we have used this opportunity wisely and fully.

Streamlined Coverage

As part of our ongoing effort to streamline presentation, respond to reviewer input, and keep costs down for students, we have moved some material from the previous edition to our website, www.brue3e.com. The Chapter One appendix on **Graphs and Their Meaning** and the resource market chapters on **Wage Determination** and **Income Inequality and Poverty** (formerly Chapters 10 and 11, respectively) have been moved to the web. Instructors who cover these chapters will find them easily accessible and that updates of the content and supplements have received the same careful attention as the rest of the book.

New Discussions of the Financial Crisis and the Recession

In this edition, we have focused on incorporating an analysis of the financial crisis, the recession, and the hesitant recovery into our discussions of macroeconomics. Although we found many ways to work the recession into our macro chapters, we are confident that our basic macroeconomic models will serve equally well in explaining economic recovery and expansion back to the economy's historical growth path. The new inclusions relating to the recession simply help students see the relevance of the models to what they are seeing in the news and perhaps experiencing in their own lives. The overall tone of the book, including the macro, continues to be optimistic with respect to the long-term growth prospects of market economies.

Reworked End-of-Chapter Questions and Problems

We have extensively reworked the end-of-chapter questions, and we have added new problems to each chapter. The questions are analytic and often ask for free responses, whereas the problems are mainly quantitative. We have aligned the questions and problems with the learning objectives presented at the beginning of the chapters. All of the questions and problems are assignable through McGraw Hill's *Connect Economics*, and many contain additional algorithmic variations and can be automatically graded within the system.

Chapter-by-Chapter Changes

In addition to the changes and new features listed above, chapter-specific revisions include:

Chapter 1: Limits, Alternatives, and Choices features updated discussion of the 2007–2009 recession and streamlined coverage of the main concepts. The **Chapter One Appendix: Graphs and Their Meaning** has been moved to our website, www.brue3e.com.

Chapter 2: The Market System and the Circular Flow includes an improved discussion of the circular flow model, additional coverage of property rights, and updated global data.

Chapter 3: Demand, Supply, and Market Equilibrium begins with a revised introduction to supply and demand and contains additional clarifications of key concepts.

Chapter 4: Elasticity of Demand and Supply provides an updated discussion of elasticity.

Chapter 5: Market Failures: Public Goods and Externalities features improved coverage of market failures, enhanced discussion of public versus private goods, a new

“Illustrating the Idea” piece on the Coase Theorem, and a more complete discussion of correcting for externalities.

Chapter 6: Businesses and Their Costs includes an improved discussion of costs and a new “Applying the Analysis” piece that discusses rising gas prices.

Chapter 7: Pure Competition features revised discussions of pure competition in the long run and efficiency in pure competition, plus an expanded figure illustrating a competitive firm and market in long-run equilibrium.

Chapter 8: Pure Monopoly contains an updated figure showing the inefficiency of pure monopoly relative to a purely competitive industry and a revised discussion of efficiency.

Chapter 9: Monopolistic Competition and Oligopoly includes a revised introduction, an updated figure illustrating the inefficiency of monopolistic competition, and an improved discussion of cartels and collusion.

Chapter 10: GDP and Economic Growth includes a revised discussion of GDP accounting and updated coverage of productivity changes.

Chapter 11: Business Cycles, Unemployment, and Inflation contains a new chapter introduction, an improved discussion of business cycles and their causes, and detailed coverage of current unemployment rates and inflation throughout the world.

Chapter 12: Aggregate Demand and Aggregate Supply features detailed discussion, application, and analysis of the recession of 2007–2009.

Chapter 13: Fiscal Policy, Deficits, and Debt includes important updates related to the recession, the subsequent policy response, and the debt debate.

Chapter 14: Money, Banking, and Financial Institutions provides an extensive discussion of the 2007–2008 financial crisis and the postcrisis financial services industry.

Chapter 15: Interest Rates and Monetary Policy features updated coverage of recent U.S. monetary policy, a new explanation of the liquidity trap, a new discussion of the Fed’s response to the financial crisis, and a new “Applying the Analysis” piece on the Fed’s balance sheet and its extensive growth.

Chapter 16: International Trade and Exchange Rates includes updated material on recent U.S. trade deficits and a revised discussion related to changes in the relative value of the U.S. dollar.

Chapters on Wage Determination and Income Inequality and Poverty have been relocated to our website, www.brue3e.com. Revisions include improved discussion and significant updates to the data on distribution of income, poverty, and income maintenance programs.

Distinguishing Features and Third Edition Changes

Essentials of Economics includes several features that we think add up to a unique whole.

State-of-the-Art Design and Pedagogy

Essentials incorporates a single-column design with a host of pedagogical aids, including a strategically placed “To the Student” statement, chapter opening objectives, definitions in the margins, combined tables and graphs, complete chapter summaries, lists of key terms, carefully constructed study questions, connections to our

To the Student

This book and its ancillaries contain several features designed to help you learn economics:

- **Icons in the margins** A glance through the book reveals many pages with web buttons in the margins. Three differing colored rectangular indicators appear throughout the book, alerting you when complementary content on a subject can be found at our Online Learning Center, www.lope.com. The **Worked Problems** serve as your “cookbook” for problem solving. Numeric problems are presented and then solved, side-by-side, step-by-step. Seeing how the problems are worked will help you solve similar problems on quizzes and exams. Practice hands-on graph work with the **Interactive Graphs** exercises. Manipulate the graphs by clicking on a specific curve and dragging it to a new location. This interaction will enhance your understanding of the underlying concepts. The **Origin of the Idea** pieces trace a particular idea to the person or persons who first developed it.

WORKED PROBLEMS

W 1.1
Budget lines

INTERACTIVE GRAPHS

G 3.1
Supply and demand

ORIGIN OF THE IDEA

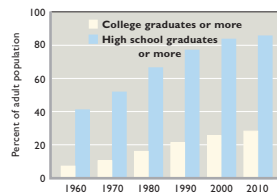
O 2.2
Specialization/division of labor

- **Other Internet aids** Our Internet site contains many other aids. In the student section at the Online Learning Center, you will find self-testing multiple-choice quizzes, PowerPoint slides, and much more.
- **Appendix on graphs** To understand the content in this book, you will need to be comfortable with basic graphical analysis and a few quantitative concepts. The web appendix for Chapter 1 reviews graphing and slopes of curves. Be sure not to skip it.
- **Key terms** Key terms are set in boldface type within the chapters, defined in the margins, listed at the end of each chapter, and again defined in the Glossary toward the end of the book.

FIGURE 10.3

Changes in the educational attainment of the U.S. adult population. The percentage of the U.S. adult population, age 25 or more, completing high school and college (bachelor's degree or higher) has been rising over recent decades.

Source: U.S. Census Bureau, www.census.gov.



Illustrating the Idea

A Bit of a Stretch

The following analogy might help you remember the distinction between “elastic” and “inelastic.” Imagine two objects: (1) an Ace elastic bandage used to wrap injured joints and (2) a relatively firm rubber tie-down used for securing items for transport. The Ace bandage stretches a great deal when pulled with a particular force; the rubber tie-down stretches some, but not a lot.

Similar differences occur for the quantity demanded of various products when their prices change. For some products, a price change causes a substantial “stretch” of quantity demanded. When this stretch in percentage terms exceeds the percentage change in price, demand is elastic. For other products, quantity demanded stretches very little in response to the price change. When this stretch in percentage terms is less than the percentage change in price, demand is inelastic.

website, an appendix on graphs and a web appendix on additional examples of demand and supply, an extensive glossary, and historical statistics on the inside covers.

Focus on Core Models

Essentials of Economics shortens and simplifies explanations where appropriate but stresses the importance of the economic perspective, including explaining and applying core economic models. Our strategy is to develop a limited set of essential models, illustrate them with analogies or anecdotes, explain them thoroughly, and apply them to real-world situations. Eliminating unnecessary graphs and elaborations makes perfect sense in the one-semester course, but cutting explanations of the truly *essential* graphs does not. In dealing with the basics, brevity at the expense of clarity is false economy.

We created a student-oriented one-semester textbook that draws on the methodological strengths of the discipline and helps students improve their analytical reasoning skills. Regardless of students’ eventual majors, they will discover that such skills are highly valuable in their workplaces.

Illustrating the Idea

We include numerous analogies, examples, and anecdotes to help drive home central economic ideas in a lively, colorful, and easy-to-remember way. For instance, elastic versus inelastic demand is illustrated by comparing the stretch of an Ace bandage and that of a tight rubber tie-down. Student exam scores help demonstrate the difference between marginal product and average product. Public goods and the free-rider problem are illustrated by public art, while a pizza analogy walks students through the equity-efficiency trade-off. Inflation as a hidden tax is illustrated by a story of the prince of the realm clipping coins. These brief vignettes flow directly from the preceding content and segue to the content that follows, rather than being “boxed off” away from the flow and therefore easily overlooked.

New to this edition is an *Illustrating the Idea* piece about beekeepers that is used to explain the Coase Theorem.

Applying the Analysis

A glance though this book’s pages will demonstrate that this is an application-oriented textbook. *Applying the Analysis* pieces immediately follow the development of economic analysis and are part of the flow of the chapters, rather than segregated from the main-body discussion in a traditional boxed format. For example, the basics of the economic perspective are applied to why customers tend to try to wait in the shortest checkout lines. The book illustrates inelasticity of demand (with changing supply) with an explanation of fluctuating farm income. Differences in elasticity of

supply are contrasted by the changing prices of antiques versus reproductions. Hidden car-retrieval systems (such as Lojack) explain the concept of positive externalities. The book describes the principal-agent problem via the problems of corporate accounting and financial fraud. The idea of minimum efficient scale is applied to ready-mix concrete plants and assembly plants for large commercial airplanes. The difference in adult and child pricing for tickets to a ballgame compared to the pricing at the concession stands illustrates the concept of price discrimination. The aggregate demand model is applied to specific periods of inflation and recession, while the trade theory discussion touches on the issue of the offshoring of U.S. jobs. These and many other applications clearly demonstrate to beginning students the relevance and usefulness of mastering the basic economic principles and models.

Applications covering rising gasoline prices, the Federal Reserve's balance sheet, and the financial crisis have been added to this edition.

Photo Ops

Photo sets called *Photo Ops* are included throughout the book to add visual interest, break up the density, and highlight important distinctions. Just a few of the many examples are sets of photos on complements versus substitutes in consumption, homogeneous versus differentiated products, economic stocks versus economic flows, substitute resources versus complementary resources, consumer durables versus nondurables versus services, and intermediate versus final goods.

Photo Ops on traffic congestion and holiday lighting contrast negative and positive externalities, large- and small-scale production activities illustrate economies and diseconomies of scale, and Social Security checks and food stamps highlight the differences between social insurance and public assistance.

Web Buttons

We link the book directly to our website, www.brue3e.com, via icons that appear throughout the book to indicate that additional content on a subject can be found online. There are three Button types:

- The teal rectangle to the left directs students to **Interactive Graphs**. Developed under the supervision of Norris Peterson of Pacific Lutheran University, this interactive feature depicts major graphs and instructs students to shift the curves, observe the outcomes, and derive relevant generalizations. This hands-on graph work will greatly reinforce the main graphs and their meaning.
- The green rectangle directs students to **Origins of the Idea**. These brief histories, written by Randy

Applying the Analysis

Price Floors on Wheat

A **price floor** is a minimum price fixed by the government. A price at or above the price floor is legal; a price below it is not. Price floors above equilibrium prices are usually invoked when society feels that the free functioning of the market system has not provided a sufficient income for certain groups of resource suppliers or producers. Supported prices for agricultural products and current minimum wages are two examples of price (or wage) floors. Let's look at the former.

Suppose that many farmers have extremely low incomes when the price of wheat is at its equilibrium value of \$2 per bushel. The government decides to help out by establishing a legal price floor (or "price support") of \$3 per bushel.

What will be the effects? At any price above the equilibrium price, quantity supplied will exceed quantity demanded—that is, there will be a persistent surplus of the product. Farmers will be willing to produce and offer for sale more wheat than private buyers are willing to buy at the \$3 price floor. As we saw

price floor

A legally established minimum (above-equilibrium) price for a product.




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Photo Op Substitutes versus Complements

Different brands of soft drinks are substitute goods, goods consumed jointly such as hot dogs and mustard are complementary goods.

INTERACTIVE GRAPHS

G 13.1

Crowding out

ORIGIN OF THE IDEA

O 13.1

Crowding out

Crowding-Out Effect

crowding-out effect
A decrease in private investment caused by higher interest rates that result from the federal government's increased borrowing to finance deficits (or debt).

Another potential flaw of fiscal policy is the so-called **crowding-out effect**: An expansionary fiscal policy (deficit spending) may increase the interest rate and reduce investment spending, thereby weakening or canceling the stimulus of the expansionary policy. The rising interest rate might also potentially crowd out interest-sensitive consumption spending (such as purchasing automobiles on credit). But since investment is the most volatile component of GDP, the crowding-out effect focuses its attention on investment and whether the stimulus provided by deficit spending may be partly or even fully neutralized by an offsetting reduction in investment spending.

To see the potential problem, realize that whenever the government borrows money (as it must if it is deficit spending), it increases the overall demand for money. If the monetary authorities are holding the money supply constant, this increase in demand will raise the price paid for borrowing money: the interest rate. Because investment spending varies inversely with the interest rate, some investment will

INTERACTIVE GRAPHS

G 13.1

Crowding out

ORIGIN OF THE IDEA

O 13.1

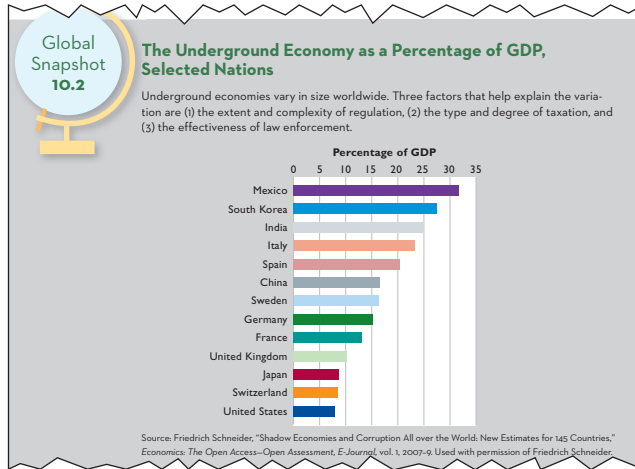
Crowding out

WORKED PROBLEMS

W 1.1
Budget lines

Grant of Linfield College (OR), examine the origins of scores of major ideas identified in the book. Students will find it interesting to learn about the economists who first developed such ideas as opportunity costs, equilibrium price, creative destruction, comparative advantage, and elasticity.

- The blue rectangle to the left is our web button that directs students to **Worked Problems**. Written by Norris Peterson, these pieces consist of side-by-side computational questions and computational procedures used to derive the answers. From a student perspective, they provide “cookbook” help for problem solving.



Global Snapshots

Global Snapshot pieces show bar charts and line graphs that compare data for a particular year or other time period among selected nations. Examples of lists and comparisons include income per capita, the world’s 10 largest corporations, the world’s top brand names, standardized budget deficits or surpluses, the index of economic freedom, sizes of underground economies, rates of economic growth, exports as percentages of GDP, and so forth. These Global Snapshots join other significant international content to help convey that the United States operates in a global economy.

Pedagogical Aids

Supplements for Students

Essentials of Economics, 3e is accompanied by many high-quality supplements that help students master the subject.

- **Study Guide** One of the world’s leading experts on economic education—William Walstad of the University of Nebraska at Lincoln—has prepared the *Study Guide*. Each chapter contains an introductory statement, a checklist of behavioral objectives, an outline, a list of important terms, fill-in questions, problems and projects, objective questions, and discussion questions. The text’s glossary is repeated in the *Study Guide* so that the student does not have to go back and forth between books. Many students will find this printed “portable tutor” indispensable.
- **Online Learning Center (www.brue3e.com)** Along with the *Interactive Graphs*, *Worked Problems*, and *Origin of the Idea* pieces, the student portion of the website includes many learning aids for students. For example, there are web-based study questions, self-grading quizzes updated and revised by Emilio Gomez of Palomar College, learning objectives, and PowerPoint presentations—all specific to *Essentials of Economics*, 3e. Students can also access the Solman videos, a set of more than 250 minutes of video created by Paul Solman of *The News Hour with Jim Lehrer*. These videos cover core economic concepts such as elasticity, deregulation, and perfect competition. Students can watch this material on their computers or download the content to a smartphone or tablet.