



PREFACE

Although many billions of dollars are spent each year on introductory economics instruction in colleges and universities worldwide, the return on this investment has been disturbingly low. Studies have shown, for example, that several months after having taken a principles of economics course, former students are no better able to answer simple economic questions than others who never even took the course. Most students, it seems, leave our introductory courses without having learned even the most important basic economic principles.

The problem, in our view, is that these courses almost always try to teach students far too much. In the process, really important ideas get little more coverage than minor ones, and everything ends up going by in a blur. Many instructors ask themselves, “How much can I cover today?” when instead they should be asking, “How much can my students absorb?”

Our textbook grew out of our conviction that students will learn far more if we attempt to cover much less. Our basic premise is that a small number of basic principles do most of the heavy lifting in economics, and that if we focus narrowly and repeatedly on those principles, students can actually master them in just a single semester.

The enthusiastic reactions of users of the original U.S. editions affirm the validity of this premise. Avoiding excessive reliance on formal mathematical derivations, we present concepts intuitively through examples drawn from familiar contexts. We rely throughout on a well-articulated list of seven Core Principles, which we reinforce repeatedly by illustrating and applying each principle in numerous contexts. We ask students periodically to apply these principles themselves to answer related questions, exercises, and problems.

Throughout this process, we encourage students to become “economic naturalists,” people who employ basic economic principles to understand and explain what they observe in the world around them. An economic naturalist understands, for example, that infant safety seats are required in cars but not in airplanes because the marginal cost of space to accommodate these seats is typically zero in cars but often hundreds of dollars in airplanes. Scores of such examples are sprinkled throughout the book. Each one, we believe, poses a question that should make any curious person eager to learn the answer. These

examples stimulate interest while teaching students to see each feature of their economic landscape as the reflection of one or more of the Core Principles. Students talk about these examples with their friends and families. Learning economics is like learning a language. In each case, there is no substitute for actually speaking. By inducing students to speak economics, the economic naturalist examples serve this purpose.

For those who would like to learn more about the role of examples in learning economics, Bob Frank’s lecture on this topic is posted on YouTube’s “Authors@Google” series (www.youtube.com/watch?v=QalNVxeIKEE or search “Authors@Google: Robert Frank”).

KEY THEMES AND FEATURES

An Emphasis on Seven Core Principles

As noted, a few core principles do most of the work in economics. By focusing almost exclusively on these principles, the text assures that students leave the course with a deep mastery of them. In contrast, traditional encyclopedic texts so overwhelm students with detail that they often leave the course with little useful working knowledge at all.

- **The Scarcity Principle:** Having more of one good thing usually means having less of another.
- **The Cost-Benefit Principle:** Take no action unless its marginal benefit is at least as great as its marginal cost.
- **The Incentive Principle:** Cost-benefit comparisons are relevant not only for identifying the decisions that rational people should make, but also for predicting the actual decisions they do make.
- **The Principle of Comparative Advantage:** Everyone does best when each concentrates on the activity for which he or she is relatively most productive.
- **The Principle of Increasing Opportunity Cost:** Use the resources with the lowest opportunity cost before turning to those with higher opportunity costs.
- **The Efficiency Principle:** Efficiency is an important social goal because when the economic pie grows larger, everyone can have a larger slice.

- **The Equilibrium Principle:** A market in equilibrium leaves no unexploited opportunities for individuals but may not exploit all gains achievable through collective action.

Economic Naturalism

Our ultimate goal is to produce economic naturalists—people who see each human action as the result of an implicit or explicit cost-benefit calculation. The economic naturalist sees mundane details of ordinary existence in a new light and becomes actively engaged in the attempt to understand them. Some representative examples:

In Micro:

- Why do movie theatres offer discount tickets to students?
- Why do we often see convenience stores located on adjacent street corners?
- Why do supermarket checkout lines all tend to be roughly the same length?

In Macro:

- Why has investment in computers increased so much in recent decades?
- Why does news of inflation hurt the stock market?
- Why do almost all countries provide free public education?

Active Learning Stressed

The only way to learn to hit an overhead smash in tennis is through repeated practice. The same is true for learning economics. Accordingly, we consistently introduce new ideas in the context of simple examples and then follow them with applications showing how they work in familiar settings. At frequent intervals, we pose concept checks that both test and reinforce the understanding of these ideas. The end-of-chapter questions and problems are carefully crafted to help students internalize and extend core concepts. Experience with earlier editions confirms that this approach really does prepare students to apply basic economic principles to solve economic puzzles drawn from the real world.

Modern Microeconomics

- *Economic surplus*, introduced in Chapter 1 and employed repeatedly thereafter, is more fully developed

here than in any other text. This concept underlies the argument for economic efficiency as an important social goal. Rather than speak of trade-offs between efficiency and other goals, we stress that maximizing economic surplus facilitates the achievement of *all* goals.

- *Common decision pitfalls* identified by 2002 Nobel Laureate Daniel Kahneman and others—such as the tendency to ignore implicit costs, the tendency not to ignore sunk costs, and the tendency to confuse average and marginal costs and benefits—are introduced early in Chapter 1 and invoked repeatedly in subsequent chapters.
- There is perhaps no more exciting toolkit for the economic naturalist than a few *principles of elementary game theory*. In Chapter 9, we show how these principles enable students to answer a variety of strategic questions that arise in the marketplace and everyday life. We believe that the insights of the Nobel Laureate Ronald Coase are indispensable for understanding a host of familiar laws, customs, and social norms. In Chapter 10 we show how such devices function to minimize misallocations that result from externalities.

Modern Macroeconomics

The *severe economic downturn* that began in late 2007 has renewed interest in cyclical fluctuations without challenging the importance of such long-run issues as growth, productivity, the evolution of real wages, and capital formation. Our treatment of these issues is organized as follows:

- A three-chapter treatment of *long-run issues*, followed by a modern treatment of *short-term fluctuations and stabilization policy*, emphasizes the important distinction between short- and long-run behavior of the economy.
- *Designed to allow for flexible treatment of topics*, these chapters are written so that short-run material (Chapters 21–25) can be used before long-run material (Chapters 18–20) with no loss of continuity.
- This book places a heavy emphasis on *globalization*, starting with an analysis of its effects on real wage inequality and progressing to such issues as the benefits of trade, the role of capital flows in domestic capital formation, and the links between exchange rates and monetary policy.

ORGANIZATION OF THIS EDITION

In Microeconomics

- **More and clearer emphasis on the Core Principles:** If we asked a thousand economists to provide their own versions of the most important economic principles, we'd get a thousand different lists. Yet to dwell on their differences would be to miss their essential similarities. It is less important to have exactly the best short list of principles than it is to use some well-thought-out list of this sort.
- **Outsourcing discussion supports comparative advantage material:** In Chapter 2, students will see a full-spectrum view of production possibilities and the realities economies face considering outsourcing decisions.
- **Strong connection drawn between core concepts:** Chapter 7 makes strong connections among market equilibrium and efficiency, the cost of preventing price adjustments, economic profit, and the Invisible Hand theory.
- **Using economics to help make policy decisions:** Chapters 12 and 13 feature important policy decisions and uses economics to sort out the best options. Health care, environmental regulation, international trade, and income redistribution are all discussed.

In Macroeconomics

- **Flexible, modular presentation:** Part 5, “Macroeconomics: Data and Issues,” is a self-contained group of chapters that covers measurement issues. This allows instructors to proceed to either the long run (Part 6, “The Economy in the Long Run”) or the short run (Part 7, “The Economy in the Short Run”) first with no loss of continuity.
- **Thorough discussion of labor markets:** Labor market trends in employment, wages, and unemployment are covered together in Chapter 17 to help students fully understand the connections between all three topics.
- **Strong connection drawn between financial markets and money:** Chapter 20 brings together information on financial intermediaries, bond and stock markets, and money so that students can make the connections among stock markets, bond markets, commercial banks, and money.

- **Clear discussion of output gaps and Okun's Law:** The formulas for the output gap and Okun's Law are written out explicitly to help students apply these concepts to real-world data.
- **The simple Keynesian model:** We present the simple Keynesian model through examples that are developed both graphically and numerically.
- **Monetary policy coverage organization:** The institutional details of the Federal Reserve, the U.S. central bank, are discussed at the beginning of Chapter 23, followed by the effects of central bank's policy on planned aggregate expenditure. The money market is also discussed, but instructors who wish to skip this material can easily do so. In addition, the effects of monetary policy are summarized using logic chains that students can easily understand.
- **The presentation of aggregate demand and aggregate supply:** Chapters 24 and 25 work together to give students a thorough understanding of the *AD-AS* model.
 - In Chapter 24, we focus on the nuts and bolts of the *AD-AS* model itself. Coherent, intuitive derivations of the *AD* curve and *AS* curve are presented, with an emphasis on connecting each side of the model to concepts the students learned in previous chapters. The model is then applied to business cycles, with an emphasis on the 2007–2009 recession.
 - In Chapter 25, we apply the *AD-AS* model to macroeconomic policy. First, we focus on how fiscal and monetary policy should be conducted in the face of shocks to aggregate demand and aggregate supply. We then examine the role of inflation expectations and credibility in policy-making, and link this to a discussion of inflation targeting. Finally, we analyze the effects of fiscal policy on long-run growth with an emphasis on how changes in marginal tax rates can affect labor supply and hence potential output.
- **Flexible coverage of international economics:** Chapter 26 is a self-contained discussion of exchange rates that can be used whenever an instructor thinks it best to introduce this important subject. This chapter also integrates the discussion of trade and capital flows so that students see that the balance of trade and net capital inflows are two sides of the same issue.

All currency amounts are expressed in U.S. dollars unless specified otherwise.

WHAT'S NEW TO THIS EDITION

In Asia and many parts of the world, students taking introductory economics usually read principles of economics textbooks written by American professors. Naturally, these professors used cases and examples that their students are most familiar with to illustrate core economics concepts. In general, Asian readers have little knowledge about American cases and examples, which in turn hinders their ability to apprehend the applications of core economics principles to real life examples. For example, baseball is a popular sport in North America but not so in Asia. While Americans often eat pizza, Asians do not have a strong preference for pizza. However, as the United States is one of the most important economic powers in the world, it is instrumental for all economics students, Americans and Asians alike, to understand its market structure and financial system. Moreover, famous U.S. television programs are broadcasted through television stations around the world with or without translation.

With the advancement in information technology and the high penetration of smartphone with internet access, people around the world are becoming closer to one another. Local news may spread across the globe within hours and a trendy product originated from a city may become a worldwide hit in weeks. For example, pearl milk tea, which used to be a popular local drink in Taiwan, is widely available in many parts of the world today. Therefore, students taking introductory economics in any country should take a global perspective and can benefit from studying real life examples selected from different parts of the globe.

Cases and examples included in this book are carefully selected to arouse the interest of target readers. All products and services discussed, such as donuts and smartphones, are familiar to youngsters worldwide. Celebrities chosen to illustrate core concepts, such as LeBron James, are household names around the world. Although this book is targeted at economics students in Asia, it is also equally appealing to youngsters around the globe. In short, *Principles of Economics: Asia Global Edition, 1/e* provides students with a lens through which to view, understand, and analyze current economic scenarios by eliminating overwhelming detail. It makes extensive use of examples from Asia and North America to explain the Seven Core Principles.

ORGANIZED LEARNING IN THIS EDITION

Chapter Learning Objectives

Students and professors can be confident that the organization of each chapter surrounds common themes

outlined by four to seven learning objectives listed on the first page of each chapter. These objectives, along with AACSB and Bloom's Taxonomy Learning Categories, are connected to all Test Bank questions and end-of-chapter material to offer a comprehensive, thorough teaching and learning experience.

Assurance of Learning Ready

Many educational institutions today are focused on the notion of assurance of learning, an important element of some accreditation standards. *Principles of Economics, Asia Global Edition, 1/e* is designed specifically to support your assurance of learning initiatives with a simple, yet powerful, solution.

You can use our test bank software, EZ Test, to easily query for learning objectives that directly relate to the objectives for your course. You can then use the reporting features of EZ Test to aggregate student results in a similar fashion, making the collection and presentation of assurance of learning data simple and easy.

AACSB Statement

The McGraw-Hill Companies is a proud corporate member of AACSB International. Recognizing the importance and value of AACSB accreditation, the authors of *Principles of Economics, Asia Global Edition, 1/e* have sought to recognize the curricula guidelines detailed in AACSB standards for business accreditation by connecting questions in the test bank and end-of-chapter material to the general knowledge and skill guidelines found in AACSB standards. It is important to note that the statements contained in *Principles of Economics, Asia Global Edition, 1/e* are provided only as a guide for the users of this text.

A NOTE ON THE WRITING OF THE U.S. EDITION

Ben Bernanke was sworn in on February 1, 2006, as Chairman and a member of the Board of Governors of the Federal Reserve System, a position to which he was reappointed in January 2010. From June 2005 until January 2006, he served as chairman of the President's Council of Economic Advisers. These positions have allowed him to play an active role in making U.S. economic policy, but the rules of government service have restricted his ability to participate in the preparation of the fifth edition.

Fortunately, we were able to enlist the aid of Louis D. Johnston of the College of Saint Benedict | Saint John's University to take the lead in creating the macro portion of the original U.S. edition. Ben Bernanke and Robert Frank

express their deep gratitude to Louis for the energy and creativity he has brought to his work on the U.S. edition. He has created a great tool for students and professors.

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