Contents

PART I Introduction to Economics 33	Mixed Systems, Markets, and Governments 70 Looking Ahead 70
The Scope and Method of Economics 33	Summary 70 Review Terms and Concepts 71 Problems 71
Why Study Economics? 34 To Learn a Way of Thinking 34 ECONOMICS IN PRACTICE Rainfall and Schooling	3 Demand, Supply, and Market Equilibrium 75
in India 35 ECONOMICS IN PRACTICE Majoring in Economics Makes You Less Vulnerable to a Recession! 36 To Understand Society 36 To Be an Informed Citizen 37 The Scope of Economics 37 Microeconomics and Macroeconomics 37 ECONOMICS IN PRACTICE How Italian Is a Ferrari? 38 The Diverse Fields of Economics 39 The Method of Economics 40	Firms and Households: The Basic Decision-Making Units 76 Input Markets and Output Markets: The Circular Flow 76 Demand in Product/Output Markets 78 Changes in Quantity Demanded versus Changes in Demand 78 Price and Quantity Demanded: The Law of Demand 79 Other Determinants of Household Demand 82 ECONOMICS IN PRACTICE Have You Bought This
Theories and Models 40 ECONOMICS IN PRACTICE Does Your Part-time Job Affect Your Academic Performance? 42 Economic Policy 42	Textbook? 83 ECONOMICS IN PRACTICE People Drink Tea on Rainy Days 84 Shift of Demand versus Movement along
An Invitation 44 Economic Skills and Economics as a Career 44 ummary 44 Review Terms and Concepts 45 roblems 45 Appendix: How to Read and Understand Graphs 47	a Demand Curve 85 From Household Demand to Market Demand 86 Supply in Product/Output Markets 88 Price and Quantity Supplied: The Law of Supply 89
The Economic Problem: Scarcity and Choice 55	Other Determinants of Supply 90 Shift of Supply versus Movement along a Supply Curve 91
Scarcity, Choice, and Opportunity Cost 56 Scarcity and Choice in a One-Person Economy 56 Scarcity and Choice in an Economy of Two or More 57 ECONOMICS IN PRACTICE Frozen Foods and Opportunity Costs 58	From Individual Supply to Market Supply 92 Market Equilibrium 93 Excess Demand 93 Excess Supply 95 Market Equilibrium with Equations 96 Changes in Equilibrium 96
The Production Possibility Frontier 61 The Economic Problem 67 ECONOMICS IN PRACTICE Changing Consumption	ECONOMICS IN PRACTICE Quinoa 99 Demand and Supply in Product Markets: A Review 99
Patterns in China 68 Economic Systems and the Role of Government 68	Festive Seasons 100 Looking Ahead: Markets and the Allocation

of Resources 101

Summary 101 Review Terms and Concepts 102 Problems 103

Command Economies 68

Laissez-Faire Economies: The Free Market 69

Demand and Supply Applications 106	ECONOMICS IN PRACTICE Brexit and EU Student Enrolment in the United Kingdom 137
• •	What Happens when We Raise Taxes:
The Price System: Rationing and Allocating Resources 107	Using Elasticity 137
Price Rationing 107	Looking Ahead 139
Constraints on the Market and Alternative	Summary 139 Review Terms and Concepts 140 Problems 140
Rationing Mechanisms 109	
ECONOMICS IN PRACTICE Why Do I Have to	PART II The Market System 145
Pay More for My Food? The Truth behind the Flood Crises 111 Prices and the Allocation of Resources 113	Household Behavior and Consumer Choice 148
Price Floor 113	Household Chaire in Outmut Moultage 140
Supply and Demand Analysis: Tariffs (Tax) 114	Household Choice in Output Markets 149 The Determinants of Household Demand 149
ECONOMICS IN PRACTICE The Price Mechanism	The Budget Constraint 149
at Work for Shakespeare 115	The Equation of the Budget Constraint 152
Supply and Demand and Market	The Basis of Choice: Utility 153
Efficiency 116	Diminishing Marginal Utility 153
Consumer Surplus 116	Allocating Income to Maximize Utility 154
Producer Surplus 117	The Utility-Maximizing Rule 156
Competitive Markets Maximize the Sum	ECONOMICS IN PRACTICE Sugar Tax in Chile 157
of Producer and Consumer Surplus 118	Diminishing Marginal Utility and
Potential Causes of Deadweight Loss From	Downward-Sloping Demand 157
Under- and Overproduction 119	Income and Substitution Effects 158
Looking Ahead 120	The Income Effect 158
Summary 120 Review Terms and Concepts 120 Problems 121	The Substitution Effect 159
	Household Choice in Input Markets 160
☐ Elasticity 124	The Labor Supply Decision 160
()	ECONOMICS IN PRACTICE Substitution
Price Elasticity of Demand 125	and Market Baskets 161
Slope and Elasticity 125	The Price of Leisure 161
Types of Elasticity 126	Income and Substitution Effects of a Wage
Calculating Elasticities 127	Change 162
Calculating Percentage Changes 127	ECONOMICS IN PRACTICE Part-Time Employment
Elasticity Is a Ratio of Percentages 128 The Midpoint Formula 128	for Students 163
Elasticity Changes along a Straight-Line Demand	Saving and Borrowing: Present versus Future
Curve 129	Consumption 164
Elasticity and Total Revenue 132	A Review: Households in Output and Input
The Determinants of Demand Elasticity 133	Markets 165
Availability of Substitutes 133	Summary 165 Review Terms and Concepts 166
The Importance of Being Unimportant 133	Problems 166 Appendix: Indifference Curves 170
Luxuries versus Necessities 133	
ECONOMICS IN PRACTICE Elasticities at a	The Dreduction Dresses The
Delicatessen in the Short Run and Long Run 134	7 The Production Process: The
The Time Dimension 134	Behavior of Profit-Maximizing
Other Important Elasticities 135	Firms 177
Income Elasticity of Demand 135	The Behavior of Profit-Maximizing Firms 178

Cross-Price Elasticity of Demand 135

Elasticity of Supply 136

Profits and Economic Costs 179

Short-Run versus Long-Run Decisions 180

Increasing Returns to Scale 227

The Bases of Decisions: Market Price of Outputs,	ECONOMICS IN PRACTICE Economies of Scale in
Available Technology, and Input Prices 181	Mobile Services 228
The Production Process 182	Constant Returns to Scale 228
Production Functions: Total Product, Marginal	Diseconomies of Scale 229
Product, and Average Product 182	ECONOMICS IN PRACTICE Diseconomies of Scale
Production Functions with Two Variable Factors of	in Secondary School Education 229
Production 185	U-Shaped Long-Run Average Costs 230
ECONOMICS IN PRACTICE Gains from Modern Management 186	ECONOMICS IN PRACTICE The Long-Run Average Cost Curve: Flat or U-Shaped? 230
Choice of Technology 186	Long-Run Adjustments to Short-Run
ECONOMICS IN PRACTICE How Soon Should	Conditions 231
Preventive Maintenance Be Employed? 187	Short-Run Profits: Moves In and Out
Looking Ahead: Cost and Supply 188	of Equilibrium 231
Summary 188 Review Terms and Concepts 189	The Long-Run Adjustment Mechanism:
Problems 189 Appendix: Isoquants and Isocosts 193	Investment Flows Toward Profit
	Opportunities 233
O Short-Run Costs and Output	Output Markets: A Final Word 234
Decisions 200	ECONOMICS IN PRACTICE Why is Food so Expensive at an Airport? 235
Costs in the Short Run 201	Summary 235 Review Terms and Concepts 236 Problems 236
Fixed Costs 201	Appendix: External Economies and Diseconomies 240
Variable Costs 203	
ECONOMICS IN PRACTICE How Much Do <i>Phantom</i>	4 O Input Domand: The Labor
Tickets Cost Their Producers? 208	Input Demand: The Labor
Total Costs 208	I ∪ and Land Markets 244
Short-Run Costs: A Review 210	Input Markets: Basic Concepts 245
Output Decisions: Revenues, Costs, and Profit	Demand for Inputs: A Derived Demand 245
Maximization 211	Marginal Revenue Product 245
Perfect Competition 211	ECONOMICS IN PRACTICE MBA or Not for the
Total Revenue and Marginal Revenue 212	Greek Youth? 246
Comparing Costs and Revenues to Maximize Profit 212	ECONOMICS IN PRACTICE How Much is Flexibility Worth? 248
The Short-Run Supply Curve 214	Labor Supply 248
Looking Ahead 215	Labor Markets 249
Summary 216 Review Terms and Concepts 217 Problems 217	The Firm's Labor Market Decision 249
·	ECONOMICS IN PRACTICE What Does Your Favorite
O Long-Run Costs and Output	La Liga Player Make? 250
Long-Run Costs and Output	Many Labor Markets 251
Decisions 220	Land Markets 251
Short-Run Conditions and Long-Run	Rent and the Value of Output Produced
Directions 221	on Land 252
Maximizing Profits 221	ECONOMICS IN PRACTICE Land Valuation 253
Minimizing Losses 224	Input Demand Curves 253
The Short-Run Industry Supply Curve 224	Shifts in Factor Demand Curves 253
Long-Run Directions: A Review 226	Profit-maximizing Condition in Input
Long-Run Costs: Economies and Diseconomies	Markets 255
of Scale 226	Looking Ahead 255

Summary 256 Review Terms and Concepts 256 Problems 257

Input Demand: The Capital Market and the Investment Decision 260

Capital and Investment 261

Capital 261

The Demand for New Capital and the Investment Decision 262

Forming Expectations 263

Comparing Costs and Expected Returns 264

The Capital Market 266

ECONOMICS IN PRACTICE Saudi Arabia's

Vision 2030 267

Capital Income: Interest and Profits 268

Financial Markets in Action 269

ECONOMICS IN PRACTICE The Stock Market 270

ECONOMICS IN PRACTICE Do Children Learn or

Inherit Investing Strategies from Their Parents? 271

Capital Accumulation and Allocation 271

A Final Word on Capital 271

Summary 272 Review Terms and Concepts 273

Problems 273 Appendix: Calculating Present Value 275

12 General Equilibrium and the Efficiency of Perfect Competition 281

Market Adjustment to Changes in Demand 282 Allocative Efficiency and Competitive

Equilibrium 284

Pareto Efficiency 284

ECONOMICS IN PRACTICE Cutting Rice Cultivation

and Water Rationing in Egypt 285

The Efficiency of Perfect Competition 286

Perfect Competition versus Real Markets 289

The Sources of Market Failure 290

Imperfect Competition 290

Public Goods 290

Externalities 291

Imperfect Information 291

Evaluating the Market Mechanism 292

Summary 292 Review Terms and Concepts 293 Problems 293

PART III Market Imperfections and the Role of Government 296

13 Monopoly and Antitrust Policy 296

Imperfect Competition and Market Power: Core Concepts 297

Forms of Imperfect Competition and Market Boundaries 297

Price and Output Decisions in Pure Monopoly Markets 298

Demand in Monopoly Markets 298

ECONOMICS IN PRACTICE Figuring Out the Right

Price 299

Perfect Competition and Monopoly

Compared 304

Monopoly in the Long Run: Barriers to

Entry 305

ECONOMICS IN PRACTICE Is Being a Monopolist

Always Good? 306

The Social Costs of Monopoly 308

Inefficiency and Consumer Loss 308

Rent-Seeking Behavior 310

Price Discrimination 311

Examples of Price Discrimination 312

ECONOMICS IN PRACTICE Price Discrimination

at Work: The Uffizi Gallery 313

Remedies for Monopoly: Antitrust Policy 314

Major Antitrust Legislation 314

ECONOMICS IN PRACTICE What Tesla Does with

Near-Monopoly Power 315

Imperfect Markets: A Review and a Look

Ahead 316

Summary 316 Review Terms and Concepts 317

Problems 318

14 Oligopoly 321

Market Structure in an Oligopoly 322

ECONOMICS IN PRACTICE Patents in the

Smartphone Industry 324

Oligopoly Models 325

The Collusion Model 325

The Price-Leadership Model 326

ECONOMICS IN PRACTICE The Philippines' Rice

Cartel 326

The Cournot Model 327

ECONOMICS IN PRACTICE The Economics of

Treating Cancer 329

Game Theory 330

Repeated Games 332

ECONOMICS IN PRACTICE Confusing Prices 334

A Game with Many Players: Collective Action Can Be Blocked by a Prisoner's Dilemma 334

Oligopoly and Economic Performance 335

Industrial Concentration and Technological

Change 336

The Role of Government 337	
Regulation of Mergers 337	S
ECONOMICS IN PRACTICE Brazil's Pulp Giant 33	38
A Proper Role for Government? 339	
Summary 340 Review Terms and Concepts 341 Problems 3	41
15 Monopolistic Competition 344	1
Industry Characteristics 345	
Product Differentiation and Advertising 346	
How Many Varieties? 346	
How Do Firms Differentiate Products? 347	
ECONOMICS IN PRACTICE Rational Excess Variety or Diversification Bias? 348	,
ECONOMICS IN PRACTICE Even Your Hair Needs Coaching 350	
Advertising 350	
ECONOMICS IN PRACTICE Oprah Winfrey's Celebrity Endorsements Sell Books! 352	
Price and Output Determination in	
Monopolistic Competition 353 Product Differentiation and Demand Elasticity 35	2
Price/Output Determination in the Short	• •
Run 353	
Price/Output Determination in the Long Run 35	54 _S
Economic Efficiency and Resource	3
Allocation 355	
Summary 356 Review Terms and Concepts 357 Problems 35	5 <i>7</i>
16 Externalities, Public Goods, and Common Resources 359	
Externalities and Environmental Economics 360	
Marginal Social Cost and Marginal Cost Pricing 36	so.
ECONOMICS IN PRACTICE Adjusting to the Environmental Effects of Globalization 362	
Costs and Benefits of Pollution 363	
Internalizing Externalities 365	
ECONOMICS IN PRACTICE The Cost of Emissions 370	
ECONOMICS IN PRACTICE Emissions and	
Electricity Prices 372	
Public (Social) Goods 373	
The Characteristics of Public Goods 373	
Public Provision of Public Goods 374	
Optimal Provision of Public Goods 374	
-	

Local Provision of Public Goods: Tiebout

Hypothesis 377

Common Resources 377

Summary 378 Review Terms and Concepts 378 Problems 379

1 7 Uncertainty and Asymmetric Information 382

Decision Making Under Uncertainty: The Tools 383

Expected Value 383

Expected Utility 383

Attitudes Toward Risk 385

Asymmetric Information 387

Adverse Selection 387

ECONOMICS IN PRACTICE Adverse Selection in the

Healthcare Market 389

Market Signaling 390

ECONOMICS IN PRACTICE The Health Care

Mandate 391

ECONOMICS IN PRACTICE How to Read

Advertisements 392

Moral Hazard 393

Incentives 393

ECONOMICS IN PRACTICE Independent Reviews

and Wanderlust 394

Labor Market Incentives 394

Summary 395 Review Terms and Concepts 396 Problems 396

18 Income Distribution and Poverty 398

The Sources of Household Income 399

Wages and Salaries 399

Income from Property 399

Income from the Government: Transfer

Payments 399

The Distribution of Market Income 399

Income Inequality in the United States 399

Causes of Inequality in Market Income 401

Inequality in Wage Income 402

ECONOMICS IN PRACTICE Inclusive Growth in South Africa 403

ECONOMICS IN PRACTICE Social Identity and Tech Jobs 404

Inequality in Property Income 405

ECONOMICS IN PRACTICE The Egyptian Revolution of Dignity 406

Arguments in Favor of Redistribution 408

Arguments for and Against Reducing

Market-Income Inequality 407

Arguments Against Redistribution 407

Redistribution of Income Through Taxes and Unemployment 447 Transfers 409 Inflation and Deflation 447 The Tax System 410 The Components of the Macroeconomy 448 The Transfer System 411 The Circular Flow Diagram 448 Redistribution Effects of Taxes and Transfers The Three Market Arenas 449 in 2013 413 The Role of the Government in Change in U.S. Inequality Over Time: 1979–2013 413 the Macroeconomy 450 Poverty 414 A Brief History of Macroeconomics 451 The Minimum Wage 415 **ECONOMICS IN PRACTICE** Macroeconomics in The Distribution of Wealth 416 Literature 452 Income Inequality in Other Countries 416 The U.S. Economy Since 1970 453 Government or the Market? A Review 417 Summary 455 Review Terms and Concepts 455 Problems 455 Summary 418 Review Terms and Concepts 419 Problems 419 **Measuring National Output Public Finance: The Economics** and National Income 457 of Taxation 422 Gross Domestic Product 458 The Basics of Taxation 423 Final Goods and Services 458 Taxes: Basic Concepts 423 **Exclusion of Used Goods and Paper ECONOMICS IN PRACTICE** Residential Property Transactions 459 Taxes in Singapore 425 **Exclusion of Output Produced Abroad** Tax Incidence: Who Pays? 426 by Domestically Owned Factors of Production 459 The Incidence of Payroll Taxes 426 Calculating GDP 460 The Incidence of Corporate Profits Taxes 429 The Expenditure Approach 460 **ECONOMICS IN PRACTICE** Economists Argue **ECONOMICS IN PRACTICE** Are Christie's Brokerage About the Incidence of the Corporate Profits Tax 431 Services Counted in GDP? 461 The Overall Incidence of Taxes in the United States: **ECONOMICS IN PRACTICE** Estimating Depreciation Empirical Evidence 431 in the National Income and Product Accounts 463 Excess Burdens and the Principle The Income Approach 464 of Neutrality 431 Nominal Versus Real GDP 466 Measuring Excess Burdens 432 **ECONOMICS IN PRACTICE** GDP: One of the Great Excess Burdens and the Degree of Distortion 433 Inventions of the 20th Century 467 The Principle of Second Best 434 Calculating Real GDP 468 Calculating the GDP Deflator 469 Optimal Taxation 434 The Problems of Fixed Weights 470 Tax Equity 434 Limitations of the GDP Concept 470 What Is the "Best" Tax Base? 435 GDP and Social Welfare 470 Social Choice 437 The Voting Paradox 437 The Informal Economy 471 Government Inefficiency: Theory of Public **ECONOMICS IN PRACTICE** An Alternative to GDP: Choice 439 The Human Development Index 471 Gross National Income per Capita 472 Rent-Seeking Revisited 440 Looking Ahead 473 Review Terms and Concepts 441 Summary 440 Problems 441 Summary 473 Review Terms and Concepts 474 Problems 474 PART IV Concepts and Problems in Macroeconomics 22 Long-Run Growth 477 **Unemployment, Inflation, and**

Unemployment 478

Unemployed in a Recession 479

Measuring Unemployment 478

ECONOMICS IN PRACTICE Time Use for the

Introduction to **Macroeconomics 444**

Macroeconomic Concerns 445 Output Growth 445

Components of the Unemployment Rate 480	The Determination of Equilibrium Output
ECONOMICS IN PRACTICE Female Labor Force	(Income) 519
Participation and Economic Development 481	Fiscal Policy at Work: Multiplier Effects 521
The Costs of Unemployment 481	The Government Spending Multiplier 521
ECONOMICS IN PRACTICE The Consequences	The Tax Multiplier 524
of Unemployment Persist 482 Inflation and Deflation 483	The Balanced-Budget Multiplier 525
The Consumer Price Index 483	The Federal Budget 527
The Costs of Inflation 485	The Budget in 2017 527
What about Deflation? 487	Fiscal Policy since 1993: The Clinton, Bush, Obama, and Trump Administrations 528
ECONOMICS IN PRACTICE Chain-Linked	ECONOMICS IN PRACTICE Regional Autonomy and
Consumer Price Index in the News 487	Government Budgeting in Spain 530
Long-run Growth 488	The Federal Government Debt 531
Output and Productivity Growth 488	The Economy's Influence on the Government
Looking Ahead 490	Budget 532
Summary 490 Review Terms and Concepts 490 Problems 491	Automatic Stabilizers and Destabilizers 532
	Full-Employment Budget 533
PART V The Core of Macroeconomic Theory 493	Looking Ahead 533
That v the dote of Management Theory 433	Summary 533 Review Terms and Concepts 534
○○ Aggregate Expenditure and	Problems 534 Appendix A 537 Appendix B 538
Equilibrium Output 495	Appendix Summary 541 Appendix Problems 541
•	
The Keynesian Theory of Consumption 496	Money, the Federal Reserve,
ECONOMICS IN PRACTICE Behavioral Biases in	25 Money, the Federal Reserve, and the Interest Rate 542
Saving Behavior 500	An Overview of Money 543
Other Determinants of Consumption 500	What Is Money? 543
Planned Investment (I) versus Actual Investment 501	ECONOMICS IN PRACTICE Don't Kill the
Planned Investment and the Interest Rate (r) 501	Birds! 544
Other Determinants of Planned Investment 502	Commodity and Fiat Monies 544
The Determination of Equilibrium Output	Measuring the Supply of Money in the United
(Income) 502	States 545
The Saving/Investment Approach to Equilibrium 505	How Banks Create Money 547
Adjustment to Equilibrium 506	A Historical Perspective: Goldsmiths 547
The Multiplier 506	ECONOMICS IN PRACTICE A Run on
ECONOMICS IN PRACTICE The Rise and Fall of	the Bank: George Bailey, Mary Poppins, Wyatt
Nokia 507	Earp 548
The Multiplier Equation 509	The Modern Banking System 549
ECONOMICS IN PRACTICE The Paradox of	The Creation of Money 550
Thrift 510	The Money Multiplier 552
The Size of the Multiplier in the Real World 511	The Federal Reserve System 553
Looking Ahead 511	Functions of the Federal Reserve 554
Summary 512 Review Terms and Concepts 512 Problems 512	The Demand for Money 555
Appendix: Deriving the Multiplier Algebraically 515	Interest Rates and Security Prices 556
	ECONOMICS IN PRACTICE Professor Serebryakov
	Makes an Economic Error 557
24 Policy 516	How the Federal Reserve Controls the Interest Rate 558
-	Tools Prior to 2008 558
Government in the Economy 517 Government Purchases (G), Net Taxes (I),	Expanded Fed Activities Beginning
and Disposable Income (Y_d) 517	in 2008 559
<u> </u>	

Looking Ahead 596

Tools After 2008 561	Summary 596 Review Terms and Concepts 596 Problems 596
Looking Ahead 562	
Summary 562 Review Terms and Concepts 563 Problems 563 Appendix 566 Appendix Problems 568	28 The Labor Market in the Macroeconomy 599
The Determination of Aggregate Output, the Price Level, and the Interest Rate 569	The Labor Market: Basic Concepts 600 The Classical View of the Labor Market 600 The Classical Labor Market and the Aggregate Supply Curve 602
	The Unemployment Rate and the Classical View 602
The Aggregate Supply (AS) Curve 570 Aggregate Supply in the Short Run 570 Shifts of the Short-Run Aggregate Supply Curve 572 The Aggregate Demand (AD) Curve 573 Planned Aggregate Expenditure and the Interest Rate 573	Explaining the Existence of Unemployment 602 Efficiency Wage Theory 603 Imperfect Information 603 Minimum Wage Laws 603 Explaining the Existence of Cyclical Unemployment 604
The Behavior of the Fed 574	Sticky Wages 604
ECONOMICS IN PRACTICE Central Bankers: Does Personality Matter? 576	ECONOMICS IN PRACTICE Evidence on Sticky Wages 605
Deriving the AD Curve 577	ECONOMICS IN PRACTICE How the Sharing
ECONOMICS IN PRACTICE Central Banks and Price	Economy Is Transforming the Job Market 606
Stability: Which Prices to Look At? 578	An Open Question 606
The Final Equilibrium 579	The Short-run Relationship Between the
Other Reasons for a Downward-Sloping AD	Unemployment Rate and Inflation 607
Curve 580	The Phillips Curve: A Historical Perspective 608
The Long Run AS Curve 580 Potential GDP 581	Aggregate Supply and Aggregate Demand Analysis and the Phillips Curve 610
ECONOMICS IN PRACTICE The Simple "Keynesian" Aggregate Supply Curve 582	Expectations and the Phillips Curve 611 Inflation and Aggregate Demand 611
Summary 583 Review Terms and Concepts 583 Problems 583	The Long-run Aggregate Supply Curve, Potential Output, and the Natural Rate
Policy Effects and Cost Shocks in the AS/AD Model 586	of Unemployment 612 The Nonaccelerating Inflation Rate of Unemployment (NAIRU) 613
Fiscal Policy Effects 587	Looking Ahead 614
Fiscal Policy Effects in the Long Run 588 Monetary Policy Effects 589	Summary 614 Review Terms and Concepts 615 Problems 615
The Fed's Response to the Z Factors 589	PART VI Further Macroeconomics Issues 618
Shape of the AD Curve When the Fed Cares More About the Price Level than Output 589 What Happens When There Is a Zero Interest Rate Bound? 590	29 Financial Crises, Stabilization, and Deficits 618
Shocks to the System 591 Cost Shocks 591	The Stock Market, the Housing Market, and Financial Crises 619
ECONOMICS IN PRACTICE South African Prices	Stocks and Bonds 619
Surge as Cape Town Goes Dry 592	Determining the Price of a Stock 619
Demand-Side Shocks 593	The Stock Market Since 1948 621
Expectations 593	Housing Prices Since 1952 622
Monetary Policy Since 1970 594	Household Wealth Effects on the Economy 623
Inflation Targeting 595	Financial Crises and the 2008 Bailout 623

The Federal Reserve Balance Sheet 560

ECONOMICS IN PRACTICE Predicting an Economy's
Future 624

Time Lags Regarding Monetary and Fiscal
Policy 625

Recognition Lags 627

Implementation Lags 627

Response Lags 628

Summary 629

Government Deficit Issues 629

Deficit Targeting 629

Summary 631 Review Terms and Concepts 632 Problems 632

Household and Firm Behavior in the Macroeconomy: A Further Look 634

Households: Consumption and Labor Supply
Decisions 635

The Life-Cycle Theory of Consumption 635

The Labor Supply Decision 636

Interest Rate Effects on Consumption 638

Government Effects on Consumption and Labor Supply: Taxes and Transfers 638

A Possible Employment Constraint on
Households 639

A Summary of Household Behavior 640

The Household Sector Since 1970 640

ECONOMICS IN PRACTICE Measuring Housing Price Changes 641

Firms: Investment and Employment Decisions 643
Expectations and Animal Spirits 643
Excess Labor and Excess Capital Effects 644
Inventory Investment 645
A Summary of Firm Behavior 646
The Firm Sector Since 1970 646
Productivity and the Business Cycle 648
The Short-Run Relationship Between Output and Unemployment 649
The Size of the Multiplier 650

ECONOMICS IN PRACTICE Estimating Multipliers:

The Mafia Link 651

Summary 651 Review Terms and Concepts 653 Problems 653

31 Long-Run Growth 655

The Growth Process: From Agriculture to Industry 656 Sources of Economic Growth 657 Increase in Labor Supply 657

ECONOMICS IN PRACTICE Government Strategy for Growth 658

Increase in Physical Capital 659
Increase in the Quality of the Labor Supply (Human Capital) 661
Increase in the Quality of Capital (Embodied Technical Change) 661

ECONOMICS IN PRACTICE Germany's Open Border Policy 662

Disembodied Technical Change 662
More on Technical Change 663
U.S. Labor Productivity: 1952 I–2017 IV 664
Growth and the Environment and Issues
of Sustainability 665

Summary 667 Review Terms and Concepts 667 Problems 668

32 Alternative Views in Macroeconomics 671

Keynesian Economics 672

Monetarism 672

The Velocity of Money 672

The Quantity Theory of Money 673

The Keynesian/Monetarist Debate 674

Supply-Side Economics 675

The Laffer Curve 675

Evaluating Supply-Side Economics 676

New Classical Macroeconomics 677

The Development of New Classical

Macroeconomics 677

Rational Expectations 678

ECONOMICS IN PRACTICE Brexit and Consumer

Expectations 679

Real Business Cycle Theory and New Keynesian
Economics 680
Evaluating the Rational Expectations
Assumption 681
Behavioral Macroeconomics 682

Testing Alternative Macroeconomic Models 682

Summary 683 Review Terms and Concepts 684 Problems 684

PART VII The World Economy 687

3 International Trade, Comparative Advantage, and Protectionism 687

Trade Surpluses and Deficits 688
The Economic Basis for Trade: Comparative
Advantage 688
Absolute Advantage versus Comparative
Advantage 689

Terms of Trade 693 Exchange Rates 694 The Sources of Comparative Advantage 696 The Heckscher-Ohlin Theorem 696 Other Explanations for Observed Trade 697 Flows Trade Barriers: Tariffs, Export Subsidies, and Quotas 697 **ECONOMICS IN PRACTICE** Globalization Improves Firm Productivity 698 U.S. Trade Policies, GATT, and the WTO 699 **ECONOMICS IN PRACTICE** What Happens When We Lift a Quota? 699 Free Trade or Protection? 701 The Case for Free Trade 701 The Case for Protection 703 **ECONOMICS IN PRACTICE** Reshaping the Global Trade Order 705 An Economic Consensus 707 Summary 707 Review Terms and Concepts 708 Problems 708 **Open-Economy Macroeconomics:** The Balance of Payments and Exchange Rates 711 The Balance of Payments 712 The Current Account 712 The Financial Account 714 **ECONOMICS IN PRACTICE** Debtor and Creditor Nations 715 Equilibrium Output (Income) in an Open Economy 715 The International Sector and Planned Aggregate Expenditure 715 Imports, Exports, and the Trade Feedback Effect 718 Import and Export Prices and the Price Feedback Effect 718 The Open Economy with Flexible Exchange Rates 719 The Market for Foreign Exchange 720 Factors That Affect Exchange Rates 723 The Effects of Exchange Rates on the Economy 725 An Interdependent World Economy Summary 728 Review Terms and Concepts 729 Problems 729

Appendix: World Monetary Systems Since 1900 731

35 Economic Growth in Developing Economies 737

Life in the Developing Nations: Population and Poverty 738

ECONOMICS IN PRACTICE What Can We Learn

from the Height of Children? 739

Economic Development: Sources and Strategies 739

The Sources of Economic Development 740

ECONOMICS IN PRACTICE Corruption 742

Strategies for Economic Development 743

ECONOMICS IN PRACTICE Who You Marry May

Depend on the Rain 745

Two Examples of Development: China and India 747

ECONOMICS IN PRACTICE Boosting Agricultural Income Through Digital Finance 748

Development Interventions 748

Random and Natural Experiments: Some New Techniques in Economic Development 749
Education Ideas 749

Health Improvements 750

Summary 751 Review Terms and Concepts 751 Problems 752

PART VIII Methodology 754

36 Critical Thinking about Research 754

Selection Bias 755

Causality 756

Correlation versus Causation 756 Random Experiments 757 Regression Discontinuity 758

Regression Discontinuity 730

ECONOMICS IN PRACTICE Moving to

Opportunity 759

ECONOMICS IN PRACTICE Control Groups and

Experimental Economics 760

Difference-in-Differences 761

ECONOMICS IN PRACTICE Using Difference-In-Differences to Study the Efficacy of Medical Insurance in Japan 762

Statistical Significance 763 Regression Analysis 764

Summary 766 Review Terms and Concepts 766 Problems 767

Glossary 769

Index 784

Credits 811