



Principles of
Economics
in Context

GOODWIN • HARRIS • NELSON • ROACH • TORRAS

P r i n c i p l e s o f
Economics
in **Context**

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Principles of Economics in Context

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 **Routledge**
Taylor & Francis Group
LONDON AND NEW YORK

First published 2014 by M.E. Sharpe

Published 2015 by Routledge
2 Park Square, Milton Park, Abingdon, Oxon OX14 4RN
711 Third Avenue, New York, NY 10017, USA

Routledge is an imprint of the Taylor & Francis Group, an informa business

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Library of Congress Cataloging-in-Publication Data

Goodwin, Neva R.

Principles of economics in context / Neva Goodwin, Jonathan Harris, Julie Nelson, Brian Roach, Mariano Torras.

pages cm

Includes index.

ISBN 978-0-7656-3882-3 (cloth : alk. paper)

1. Economics. I. Title.

HB171.G624 2014

330--dc23

2013038498

ISBN 13: 9780765638823 (hbk)

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Preface

For students taking a full-year introductory economics course, *Principles of Economics in Context* lays out the principles of economics in a manner that is thorough, up to date, and highly readable. Whether students take this class simply to gain some understanding of how economics can be useful to them, or go on to further studies in economics or business, this book will equip them with the tools and the critical understanding that they need to succeed.

Principles of Economics in Context stands apart both for its emphasis on real-world context and for its affordable price. Core economic models are presented with reference to key contemporary issues such as equity (especially income distribution), environmental sustainability, rational behavior (how realistic is “Economic Man?”), and history (path dependence and the impact of past choices on present choices). It introduces students both to the standard topics and tools taught in most introductory courses and to a broader and richer set of topics and tools to deepen comprehension of the economic realities of the twenty-first century.

This textbook is written to encourage engaged and critical thinking about topics in economics. While demonstrating the uses of economic theory, it also provides a variety of viewpoints. Woven throughout the book are themes of great importance in everyday life as well as for an understanding of the economy. There is a full treatment of standard neoclassical market theory and related topics, but the text also integrates discussion of history, institutions, gender, ethics, ecology, and inequality throughout the book. Within the broad themes of social and environmental well-being and sustainability, attention is repeatedly given to globalization, poverty and inequality, unpaid work, technology, and the environment as well as the financialization of the economy, the Great Recession, and its aftermath.

The text is priced at \$99.95, much cheaper than most competitors, and available at an even lower price if purchased on-line. The price will not rise over the life of this edition. The text is also available as an E-book for \$60 or less. The microeconomic and macroeconomic subject matter in *Principles of Economics in Context* is also available in two single-semester texts, *Macroeconomics in Context* (2nd ed.) and *Microeconomics in Context* (3rd ed.), also published by M.E. Sharpe and priced at \$59.95 (cheaper on-line).

On pages xxv–xxviii you will find several possible course plans based on different emphases (such as ecological, global, human development, and structural). We hope that this will help in planning the course that will best suit the needs of instructors and students.

WHAT MAKES THIS BOOK DIFFERENT FROM OTHER TEXTS?

This text covers the traditional topics included in most economics texts but treats them from a broader, more holistic perspective. The following chapter-by-chapter synopsis shows how this book manages both to be “similar enough” to fit into a standard curriculum and “different enough” to respond to commonly expressed needs and dissatisfactions.

Chapter 0, “Economics and Well-Being” presents graphically illustrated data on 34 variables, including data for the United States as well as international comparisons, using a selected set of countries. The related website www.gdae.org/principles allows users to see the same variables listed in order for all countries in the world where such data are available. The variables have been selected for intrinsic interest as well as relevance to the material in the rest of the book. This chapter is an innovation that teachers and students may choose to use in a variety of ways, including as an introduction to later topics, as a reference for use with other chapters, or as material to draw on in designing research projects.

Chapter 1, “Economic Activity in Context” presents standard economic topics such as the economic goals of living standards and stability—for the present and the future. These subjects are placed in a broader context of concern for well-being. The well-being goals of economics are defined as (1) improvement in living standards, (2) stability and security, and (3) financial, social, and ecological sustainability. Most textbooks discuss three essential activities—production, distribution, and consumption—but we add the activity of “resource maintenance” to draw attention to the importance of maintaining capital stocks, including stocks of natural (environmental) capital. The difference between stocks and flows is explained, and basic concepts of abundance, scarcity, tradeoffs, and opportunity costs are introduced and illustrated with production possibility curve analysis.

Chapter 2, “Useful Tools and Concepts” introduces standard concepts of economic modeling, efficiency, scarcity, and circular flow. It includes a review of graphing techniques and the use of empirical data. In addition to the usual economic “circular flow” diagram, this chapter presents an image of economic activity as embedded in social and physical contexts and relates this approach to issues of economic concern.

Chapter 3, “Markets and Society” discusses the institutional requirements of markets and introduces the concepts of externalities, public goods, market power, transaction costs, information and expectations, and concern for human needs and equity. The early introduction of these topics allows us to demonstrate why markets, while useful, are not on their own sufficient for organizing economic life in the service of well-being.

Chapter 4, “Supply and Demand” includes basic supply and demand analysis, including the slopes of supply and demand curves, factors that shift the curves, equilibrium and market adjustment, and the signaling and rationing functions of prices. Unlike many books that present equilibrium analysis as “the way the world works,” we explicitly introduce supply and demand analysis as a *tool* whose purpose is to help a person disentangle the effects of various factors on real-world prices and quantities. Rather than concentrating solely on the efficiency effects of markets, the contextual approach demands that distributional consequences and power issues also be raised.

Chapter 5, “Elasticity” presents definitions and discussions of price elasticities of demand and supply, income elasticity of demand, and the income and substitution effects of a price change.

Chapter 6, “Welfare Analysis” presents standard welfare analysis, including the topics of consumer and producer surplus. It also includes a careful look at different ways of understanding efficiency. Consideration of what is efficient—and for whom—is followed by a first look at policy conclusions that have been drawn from this approach, and a first look at the requirements for “market perfection” that underlie traditional welfare analysis.

Chapter 7, “International Trade and Trade Policy” covers the gains-from-trade story that is now so important in discussing topical issues of global commerce. (The formal theory of comparative advantage and the gains from trade is spelled out in the appendix to the chapter.) We also discuss some possible negative impacts of trade as they may affect both developed and developing countries, and put these in the context of the globalized world, as it differs from the historical example of trade between England and Portugal.

Chapter 8, “Economic Behavior and Rationality” elaborates on the topics of individual choice, rationality, and self-interest. It updates and amplifies standard expositions, drawing on studies of human economic behavior by scholars such as Herbert Simon and Daniel Kahneman, and introduces issues of organizational structure and behavior. The result is a richer picture of the complex motivations and institutions underlying real-world economic activities.

Chapter 9, “Consumption and the Consumer Society” begins by presenting the traditional utility-theoretic model of consumer behavior. The chapter explains the notion of consumer sovereignty, shows students how to graph a budget line, and explains the rule for utility maximization derived from marginal analysis. We also discuss the historical development of the “consumer society” and the psychological models of consumer behavior used in marketing research, presenting views and evidence on the relation between consumption/consumerism and happiness, and the personal and ecological impact of high-level consumption patterns. The Appendix presents a formal theory of consumer behavior, using budget lines and indifference curves to illustrate utility maximization in the standard model.

Chapter 10, “Markets for Labor” includes the traditional derivation of profit-maximizing labor demand by a perfectly informed and perfectly competitive firm. Topics include the upward-sloping and backward-bending individual paid labor supply curves. The chapter then offers additional ways of understanding how wages are determined, including theories of compensating wage differentials, market power, worker motivation, and labor market discrimination. The Appendix sets out in formal terms the standard theory of the firm’s hiring decisions.

Chapter 11, “Economic and Social Inequality” introduces Part IV, moving from definitions and measurement of inequality to data on trends in the United States and other countries. The second half of the chapter focuses on what is known about the underlying causes of inequality, and discusses possible policy responses.

Chapter 12, “Taxes and Tax Policy” starts out, like many of the other chapters in the book, with standard theory—in this case, taxes in the supply-and-demand model—and (referring back to the chapter on welfare analysis) it analyzes deadweight losses from taxes. Moving then to discuss taxation specifically in the United States, data are presented on the structure of various federal taxes, and their impacts.

Chapter 13, “The Economics of the Environment” shows how an understanding of externalities makes supply-and-demand analysis more relevant. This topic raises the problem of the valuation of externalities. We draw a distinction between standard and ecological views of the value of natural capital, raising the question of whether a standard cost-benefit framework can reasonably be applied to issues with unpredictable effects over the very long term (given the complexity of natural systems). A section on approaches to nonmarket environmental valuation is followed by a survey of some policy options for dealing with externalities. The Appendix offers a formal analysis of negative externalities.

Chapter 14, “Common Property Resources and Public Goods” differentiates between private and public goods. It relates recent work on this important topic to environmental considerations, contrasting Garrett Hardin’s “tragedy of the commons” analysis with Elinor Ostrom’s work on common property management. These analyses are then applied to a discussion of the challenge of global climate change.

Chapter 15, “Capital Stocks and Resource Maintenance” is the first of two chapters on production. It begins with a discussion of the activity of resource maintenance—that is, the importance of taking into consideration the effect of flows created by economic activity on the stocks of productive resources that will be available for future use. In a departure from other treatments, this book examines the crucial contributions of natural capital (environmental resources), human capital, and social capital to economic activity and human well-being. It also incorporates treatments of manufactured capital (machinery and physical infrastructure) and financial capital.

In **Chapter 16, “Production Costs”** the discussion of production continues with a focus on the costs of production. We present the traditional model of a firm’s cost structure, with a focus on marginal costs. The chapter includes a traditional discussion of fixed and variable inputs; diminishing, constant, and increasing returns; total and marginal costs, and short-run versus long-run issues. We set this model in context in two important ways. First, the chapter encourages students to reflect on the idea that because of externalities, private and social net benefits from production may not be equivalent. Second, the chapter offers examples of cases where other economic actors (besides firms) make production decisions, and cases where other methods of decision making are necessary.

Chapter 17, “Markets Without Power” focuses on the concept of a perfectly competitive market. Its theoretic characteristics are described, and the zero-economic-profit and efficiency outcomes are discussed. It continues the discussion from the previous chapter to explain the profit-maximizing decisions of a perfectly competitive firm. Rather than simply concluding that perfectly competitive markets are always efficient, it balances the perfectly competitive model with a discussion of efficiency and equity, including the topics of path dependence and network externalities. The Appendix offers a formal model of perfect competition.

Chapter 18: “Markets with Market Power” covers traditional models of monopoly, monopolistic competition, and oligopoly. These different market structures are presented along a competitiveness continuum, with perfect competition and pure monopoly the “ideal types” representing the opposite extremes. The chapter provides abundant examples of the different market structures, including a separate section on agriculture and health care.

Chapter 19, “Introduction to Macroeconomics” begins Part VI of the book with a presentation of basic macroeconomic concepts such as recession and inflation. It considers some micro-foundations issues including discussion of price changes that are either too slow (i.e., “sticky”) or too volatile (e.g., financial market speculation), leading to macroeconomic instability. A broad view of macroeconomic goals includes stabilization, living standards growth, and sustainability. These issues are placed in historical context, introducing themes related to classical and Keynesian economics that will be developed more fully in subsequent chapters.

Chapter 20, “Macroeconomic Measurement: The Current Approach” presents a fairly standard introduction to national income accounting but emphasizes that the accounts have been created for specific purposes, with conventions that reflect particular assumptions or choices. It notes how the production and investments undertaken in the “household and institutions” and government sectors have historically been deemphasized in national accounting.

Chapter 21, “Macroeconomic Measurement: Environmental and Social Dimensions” gives a more thorough introduction to alternative measures of economic performance than can be found in any other introductory economics textbook. The chapter briefly describes the Genuine Progress Indicator, the Better Life Index, the Human Development Index, and other current approaches for assessing well-being. It includes discussions of issues in the valuation of environmental and household services and of satellite accounts for environmental and household production.

Chapter 22, “The Structure of the U.S. Economy” is unique to this book. It describes key features of production and employment in the U.S. economy, broken down into its primary, secondary, and tertiary sectors. We include this material for several reasons. First, it makes the text more “real world” to students. Second, it provides basic economic literacy that we believe is sorely lacking among most economics students. Finally, it presents the context to illustrate several economic debates, such as the loss of manufacturing jobs, the rising costs of health care, and the meaning of the trend toward an ever-growing service sector, especially financial services. While this chapter is written with a U.S. focus, its description of sectoral shifts is relevant to many economies around the world.

Chapter 23, “Employment, Unemployment, and Wages” discusses standard macroeconomic labor topics such as the definition of the unemployment rate, the different types of unemployment, and theories of the causes of unemployment. In addition, there is a special focus on labor market institutions. The chapter discusses changes in labor force participation rates, different theories of wage determination, and the sources of wage differentials and inequalities.

Chapter 24, “Aggregate Demand and Economic Fluctuations” introduces the analysis of business cycles, presents the classical theory of savings–investment balance through the market for loanable funds, and develops Keynesian aggregate demand analysis in the form of the traditional “Keynesian cross” diagram. Our treatment of these topics is fairly standard, although our contextual approach places more emphasis on the possibility of persistent unemployment than do many other current textbooks—a perspective that is important in the light of the very slow recovery from the Great Recession.

Chapter 25, “Fiscal Policy” balances formal analysis of fiscal policy with real-world data and examples. Analysis of fiscal policy impacts is presented in fairly simple terms, with an algebraic treatment of more complex multiplier effects in appendices. While the basic analysis presented here follows the Keynesian model, the text also discusses classical and supply-side perspectives. The section on budgets and deficits should give students a basic understanding—developed further in Chapter 16—of deficits, debt, and how these affect the economy. The difference between automatic stabilizers and discretionary policy is made clear, and recent fiscal policies are discussed.

Chapter 26, “Money, Banking, and Finance” presents the basics of money and the banking system, including inflation, deflation, liquidity, and the different aggregate measures of money. Students are introduced to asset and liabilities tables, different banking institutions, and the process of money creation through the fractional reserve system. The chapter concludes with a discussion of non-bank financial institutions, financialization, and financial bubbles—topics of great relevance following the financial crisis of 2007–8.

Chapter 27, “The Federal Reserve and Monetary Policy” focuses on the role of the Federal Reserve and the implementation of monetary policy. Here we discuss the Federal Reserve’s structure, functions, and monetary policy tools that it employs to create money. The chapter also spotlights the monetary economy in the United States over the past 12 years, with particular attention to the role of monetary policy in the 2007–8 financial crisis, and the nature of the monetary response to the crisis. The chapter also contains an appendix that explains in detail the indirect effect that the Federal Reserve can have on interest rates through the workings of the market for Treasury bonds.

Chapter 28, “Aggregate Supply, Aggregate Demand, and Inflation: Putting It All Together” addresses the tricky problem of how to teach the relationship between output and inflation to introductory students in a way that is simple yet intellectually defensible. The model presented in this chapter has many features that will be familiar to instructors. But unlike *AS/AD* models that put the price level on the vertical axis, this model has the inflation rate on the vertical axis, which makes it more relevant for discussing current events.* Unlike many new classical theory–influenced textbooks, our basic presentation is not centered on a notion of long-run full-employment equilibrium output. We emphasize, instead, how the macroeconomy adjusts dynamically in the short and medium term to often-

*Regarding the theoretical underpinnings of our model, our downward-sloped *AD* curve is based on the *AD* curve developed by David Romer (“Keynesian Macroeconomics Without the LM Curve,” *Journal of Economic Perspectives* 14:2 [2000]: 149–169) and adopted by other introductory textbooks writers, including John B. Taylor (*Principles of Macroeconomics*, Houghton Mifflin, various editions). Our curved *AS* is based on the notion of an expectations-augmented Phillips curve, translated into inflation and output space. The idea of a dynamically evolving economy, rather than one always headed toward settling at full employment, is an approach based on Keynes’ own (rather than new Keynesian) thought, as explained in the appendix to Chapter 13.

unpredictable economic events. This also makes relating the model to current events more realistic. (Classical theory is not, however, neglected. It is also discussed in the chapter and the Appendix.)

Chapter 29, “The Global Economy and Policy” adds the foreign sector to the circular-flow picture, which now includes savings, investment, taxes, government spending, exports, and imports. This chapter provides a more detailed treatment than most books of the factors that influence currency exchange rates worldwide. Chapter 29 also highlights the increasingly important links between fiscal and monetary policies and the global economy. Finally, in introducing students to the World Bank and the International Monetary Fund, the chapter addresses the real-world political economy of international economic relations.

Chapter 30, “The Financial Crisis and the Great Recession” is another unique feature of this book. In treating a topic that, as of early 2014, continued to affect the lives of millions, the chapter helps add current relevance to the discussion of macroeconomic policy. Rather than develop a theoretical framework, Chapter 15 applies many of the insights introduced in earlier chapters to explain some of the likely causes and consequences of the financial crisis that led to the Great Recession. The chapter supplies an ideal context for extensive discussion of how the “real” economy relates to the financial economy, and the potential problems with an imbalance toward finance. It highlights the role of the housing bubble and subprime lending, as well as financial deregulation more generally, in creating the conditions for crisis. The latter part of the chapter discusses financial reform—efforts as well as new ideas—and asks some of the “big” questions that must be addressed if we are to avoid such crises in the future.

Chapter 31, “Deficits and Debt” is distinctive in a number of ways. First, it provides a current focus for the discussion of fiscal policy, allowing for greater elaboration on deficits and debt. Second, in an effort to alleviate the common confusion over the definition of the debt, the chapter includes a detailed classification of public and private debt types. Third, Chapter 16 analyzes the debate over stimulus versus austerity, including a contrast between how the United States and the eurozone have addressed their recent economic downturns, and considering the issue of sovereign debt. Finally, the chapter offers a survey of policy responses to the problem of long-term debt.

Chapter 32, “How Economies Grow and Develop” presents basic concepts related to economic growth, such as the Rostow and Harrod-Domar models, which emphasize the importance of investment in manufactured capital. But the chapter also provides examples of how investment in other types of capital—e.g., human or natural capital—can be equally, if not more, important, and distinguishes between growth and development. It also explores in detail the question of whether most poor countries have been “catching up” with the industrialized world (“convergence”) or falling behind. Country diversity is a recurrent theme; the chapter emphasizes that the “one size fits all” approach to economic development emphasizing structural reforms—such as those embodied in the Washington Consensus—has produced disappointing results, and that different approaches are required in response to the circumstances in individual countries.

Chapter 33, “Growth and Sustainability in the Twenty-First Century” is an unusual chapter for an economics textbook—but a crucially important one, in terms of economic education for intelligent citizenship. It examines a number of ecological challenges and includes a section on global climate change. While it covers standard theories such as the environmental Kuznets curve, it raises serious challenges to the belief that economic growth and markets on their own can solve this century’s social and environmental problems. More directly, it asks whether the traditional macroeconomic goal of continued economic growth is compatible with the long-term goal of sustainability. Finally, the chapter presents ideas

for alternative approaches at the local, national, and global level that, while sustainable, do not detract from well-being.

SPECIAL FEATURES

Each chapter in this text contains many features designed to enhance student learning.

- *Key terms* are highlighted in boldface throughout the text, with sidebar definitions for easy comprehension and review.
- *Discussion Questions* at the end of each section encourage immediate review of what has been read and relate the material to the students' own experience. The frequent appearance of these questions throughout each chapter helps students review manageable portions of material and thus boosts comprehension. The questions can be used for participatory exercises involving the entire class or for small-group discussion.
- *End-of-Chapter Review Questions* are designed to encourage students to create their own summary of concepts. They also serve as helpful guidelines to the importance of various points.
- *End-of-Chapter Exercises* encourage students to work with and apply the material, thereby gaining increased mastery of concepts, models, and investigative techniques.
- Throughout the chapters, boxes enliven the material with real-world illustrations drawn from a variety of sources regarding applications of economic concepts and recent economic developments.
- In order to make the chapters as lively and accessible as possible, some formal and technical material (suitable for inclusion in some but not all course designs) is carefully and concisely explained in chapter appendices.
- A glossary at the end of the book contains all key terms, their definitions, and the number of the chapter in which each was first used and defined.

CONTENT AND ORGANIZATION

Some of the innovative features of this text are apparent in even a quick scan of the table of contents, the sample course outlines on pp. xxv–xxviii, or Chapter 0 and Chapter 1. Although this textbook takes a broader and more contextual approach to economic activities, it fits these within a familiar overall organizational strategy.

Part I, “The Context for Economic Analysis” presents the themes of the book and the major actors in the economy. Students are introduced to a range of economic questions and goals, to basic empirical and theoretical tools, and to the basic activities and institutions of a modern economy.

Part II, “Basic Economic Analysis” introduces basic supply and demand analysis, elasticities, and welfare analysis. It also includes a chapter on international trade. Most of this material will look very familiar to teachers of economics, although this text gives greater recognition than is typical to real-world market institutions and the limitations of traditional welfare analysis.

Part III, “Economics and Society” considers the economic roles that will be familiar to all readers throughout their lives: as workers and as consumers. These roles are illustrated with examples that depart from the standard models—for example, household production is recognized throughout. This part is introduced by a chapter on economic behavior, based on the latest studies in behavioral economics. It also includes a chapter on the topic of consumerism, and one on labor markets.

Part IV, “Essential Topics for Contemporary Economics” puts the economy in a social context, with one chapter on distribution, inequality, and poverty, and another on government

roles, with an emphasis on taxes. The ecological context for the economy is then examined in two chapters that take up issues such as pollution, externalities, common property, and public goods.

Part V, “Resources, Production, and Market Organization” goes more into depth on market topics by describing the idealized model of perfect competition, presenting models of market power including monopoly, monopolistic competition, and oligopoly, and analyzing various resource markets.

Part VI, “Macroeconomic Basics” introduces basic macroeconomic definitions and accounting methods, including gross domestic product (GDP), inflation, aggregate demand, and unemployment. These are supplemented with a discussion of how new accounting systems are being developed to measure the economic contributions of the natural environment, unpaid household labor, and other previously uncounted factors. The second half of Part VI brings these abstractions down to earth with a description of the structure of the U.S. macroeconomy and discussion of the labor market and unemployment.

Part VII, “Macroeconomic Theory and Policy” explores the issue of macroeconomic fluctuations. The first chapters clearly present Keynesian and classical theories of the determination of aggregate demand (AD) and aggregate supply (AS) and the effects of fiscal and monetary policies. This section develops a dynamic AS/AD model of output and inflation that, with inflation rather than price level on the vertical axis, is designed to be comprehensible and usefully representative of the real world. It concludes with a chapter discussing macroeconomic issues in the global economy.

Part VIII, “Macroeconomic Issues and Applications” addresses the contemporary issues of financial crisis, the Great Recession, debt and deficits, economic development, and the environment. While the first two chapters here are presented from a largely U.S. perspective, the second half of this Part widens the lens to explore current global issues of poverty and inequality, economic growth, human development, and environmental challenges.

In order to focus on “contextual” discussions, formal instruction in algebraic modeling techniques is placed in optional appendices to the chapters. While this book reviews the basics of supply and demand and includes “new classical” economics among the theories discussed, it devotes fewer pages to the concept of efficient markets than many books do and certainly less than recent books that have adopted a strongly “new classical” slant. Instead, this text gives prominent consideration to new thinking in behavioral economics, analysis of financial instability and market bubbles, social and environmental issues, and policy responses to problems of unemployment, inequality, and environmental damage.

SUPPLEMENTS

The supplements package for this book provides a set of teaching tools and resources for instructors using this text. The authors have worked closely with our associate Dr. Patrick Dolenc to create an *Instructor’s Resource Manual* and Test Bank to accompany *Principles of Economics in Context*. To access these electronically, send a request via e-mail to gdae@tufts.edu that contains sufficient information for us to verify your instructor status.

For each chapter, the *Instructor’s Resource Manual* includes an introductory note and answers to all review questions and end-of-chapter exercises. In addition, the “Notes on Discussion Questions” section provides not only suggested answers to these questions but also ideas on how the questions might be used in the classroom. Sections titled “Web Resources” and “Extensions” provide supplementary material and links to other passages in the book or other materials that can be used to enrich lectures and discussion.

The Test Bank includes multiple-choice and true/false questions for each chapter. The correct answer for each question is indicated.

PowerPoint slides of figures and tables from the text and a Student Study Guide that provides ample opportunity for students to review and practice the key concepts are available for free download at www.gdae.org/principles.

ACKNOWLEDGMENTS

Principles of Economics in Context was written under the auspices of the Global Development and Environment Institute (GDAE), a research institute at Tufts University. All contributors of written materials were paid through grants raised by the Global Development and Environment Institute. By agreement with the authors, all royalties from sales of the book will go to support the work of the institute. We greatly appreciate the financial support that we have received from the V.K. Rasmussen Foundation, Spencer T. and Ann W. Olin, and the Ford, Island, and Barr Foundations.

This text has been a long time in the making, and many people have been involved along the way. First, we would like to thank Wassily Leontief, who initially urged us to write a book on economic principles for students in transitional economies. He provided inspiration and encouragement during those early years. We also are enormously grateful to Kelvin Lancaster, who allowed us to use *Modern Economics: Principles and Policy* (a textbook that he and Ronald Dulany wrote in the 1970s) as a jumping-off point for our work.

GDAE Research Fellow Anne-Marie Codur contributed to Chapter 33 on growth and sustainability, including updating the demography appendix; Dr. Nathan Perry of Colorado Mesa University contributed to Chapter 31 on deficits and debt; Ben Beachy contributed to Chapter 30 on financial crisis; and Dr. James Devine of Loyola Marymount University, Los Angeles, contributed to the macro modeling chapters.

We thank a number of instructors who were exceptionally generous in giving us detailed comments on the previous and the new edition, including Alison Butler, Willamette University; Gary Flomenhoft, University of Vermont; Robin King, Georgetown University; Dennis Leyden, University of North Carolina, Greenville; Valerie Luzadis, SUNY-ESF, Syracuse; Eric Nilsson, California State University San Bernardino; Chiara Piovani, University of Utah; Rebecca Smith, Mississippi State University; Saranna Thornton, Hampden-Sydney College; Marjolein van der Veen, Bellevue Community College; and Thomas White, Assumption College.

David Garman, of the Tufts University Economics Department, arranged an opportunity for us to class-test a very early draft of the micro portion of the text. Other faculty who assisted in the developmental stage of this text include Steven Cohn (Knox College), Julie Heath (University of Memphis), Geoffrey Schneider (Bucknell University), Robert Scott Gassler (Vesalius College of the Vrije Universiteit Brussels), Julie Matthaei (Wellesley College), and Adrian Mueller (CEPE Centre for Energy Policy and Economics).

Among the many faculty who provided valuable comments on earlier editions of the micro and macro sections, we would like to thank Sandy Baum (Skidmore College), Jose Juan Bautista (Xavier University of Louisiana), Gary Ferrier (University of Arkansas), Ronald L. Friesen (Bluffton College), and Abu N. M. Wahid (Tennessee State University), Fred Curtis (Drew University), James Devine (Loyola Marymount University), Richard England (University of New Hampshire), Mehrene Larudee (Bates College), Akira Motomura (Stonehill College), Shyamala Raman (Saint Joseph College), Judith K. Robinson (Castleton State College), Marjolein van der Veen (Bellevue Community College), Timothy E. Burson (Queens University of Charlotte), Will Cummings (Grossmont College), Dennis Debrecht (Carroll College), Amy McCormick Diduch (Mary Baldwin College), Miren Ivankovic (Southern Wesleyan University), Eric P. Mitchell (Randolph-Macon Woman's College), Malcolm Robinson (Thomas More College), June Roux (Salem Community College), Edward K. Zajicek (Kalamazoo College), Steve Balkin (Roosevelt University), Ernest Diedrich (College of St. Benedict/St. John's University), Mark Maier (Glendale Community College),

Ken Meter (Kennedy School of Government), Sigrid Stagl (University of Leeds), and Myra Strober (Stanford University), David Ciscel (University of Memphis), Polly Cleveland (Columbia University), Judex Hyppolite (Indiana University), Bruce Logan (Lesley College), Valerie Luzadis (SUNY-ESF), and Maeve Powlick (Skidmore College).

Early drafts of the micro section also formed the basis for editions designed for transitional economies, which were translated and published in Russia (Russian State University for the Humanities, 2002) and Vietnam (Hanoi Commercial University, 2002). Economists who contributed ideas to the transitional economies texts included Oleg Ananyin (Institute of Economics and Higher School of Economics, Moscow), Pham Vu Luan and Hoang Van Kinh (Hanoi Commercial University), Peter Dorman (Evergreen College); Susan Feiner (University of Southern Maine); Drucilla Barker (Hollins College); Robert McIntyre (Smith College); Andrew Zimbalist (Smith College); Cheryl Lehman (Hofstra University); and Raymond Benton (Loyola University).

Essential support work on research and manuscript preparation, including data analysis for Chapter 0, was provided by GDAE Research Coordinator Josh Uchitelle-Pierce, who took on a wide variety of tasks, solving many technical problems and maintaining a high quality of presentation throughout the volume. He was ably assisted by Mitchell Stallman, Reid Spagna, Nicholas Lusardo and Lauren Jayson. Administrative and outreach support at the Global Development and Environment Institute was provided by Casey Kennedy and Erin Coutts.

We also thank the staff of M.E. Sharpe, particularly Irene Bunnell, Angela Piliouras, and Laura Brengelman, for their enthusiasm and meticulous work in getting this book to press. Our editors, George Lobell and Patricia Kolb, contributed support and helpful suggestions throughout the process.

Finally, we would like to thank the many students we've had the privilege to teach over the years—you continually inspire us and provide hope for a bright future.

Sample Course Outlines

Providing both standard and innovative materials for introductory economics, *Principles of Economics in Context* can be used as the basis for a variety of approaches, depending on which topics and approaches are of particular interest.

To help identify the chapter assignments that make the most sense for a particular class, we have put together some ideas for course outlines below. Arranged in terms of broad selections and more specific emphases, they are designed to help instructors choose among chapters when there is not enough time to cover everything in this textbook.

We understand that in many departments one primary objective of the introductory course is to teach in some detail “how (neoclassical) economists think.” For instructors who choose to focus exclusively on neoclassical content, the most traditional combination of the selections described below—the Base Chapters, combined with some or all of the Basic Microeconomics and Basic Macroeconomics Selection and the Neoclassical Emphasis and Macro-Modeling Emphasis chapters—will provide what you need. This combination of chapters does not come close to exploiting fully the richness of *Principles of Economics in Context*, but the contextual discussions (a hallmark of this text) that are woven into the standard material will broaden the students’ understanding of economic theory and provide tools for critical thinking.

Many instructors have somewhat more leeway and can combine coverage of traditional neoclassical ideas with other material. Addressing such users of *Principles of Economics in Context*, we suggest that you make use of the special structure of the book, which enables you to introduce traditional concepts in your introductory course while still reserving class time for other areas of interest. Ecological sustainability, for example, is an issue of increasing importance and is deeply linked to the functioning of the economy. For this focus, the Base Chapters Selection and most of the Basic Microeconomics and Basic Macroeconomics Selection could be combined with the “Ecological Emphasis” Selection.

Some instructors and students may have less interest in the formalities of economic modeling, in which case it might make sense to cover the Base Chapters Selection, some material from the Basic Microeconomics and Basic Macroeconomics Selection, and much more material from the topical emphases such as “Human Development” and “Poverty/Inequality/Social Justice.” For coverage of alternative and critical perspectives, the “Critiques of Neoclassical Economics” and “Keynesian/Post-Keynesian/Institutionalist” selection will be useful.

The data presented in Chapter 0 cover a wide variety of topics and applications, and it may be appropriate to refer back to this chapter for almost any of the selections below.

BASE CHAPTERS SELECTION

- Chapter 1, “Economic Activity in Context”
- Chapter 2, “Useful Tools and Concepts”
- Chapter 3, “Markets and Society”
- Chapter 4, “Supply and Demand”

BASIC MICROECONOMICS SELECTION

- Chapter 7, “International Trade and Trade Policy,” Sections 1 and 2
- Chapter 10, “Markets for Labor,” Sections 1 and 2
- Chapter 16, “Production Costs”
- Chapter 17, “Markets Without Power,” Sections 2–4
- Chapter 18, “Markets with Power,” Sections 1–5

BASIC MACROECONOMICS SELECTION

- Chapter 19, “Introduction to Macroeconomics”
- Chapter 20, “Macroeconomic Measurement: The Current Approach”
- Chapter 23, “Employment and Unemployment”
- Chapter 24, “Aggregate Demand and Economic Fluctuations”
- Chapter 25, “Fiscal Policy”
- Chapters 26 and 27, “Money, Banking and Finance,” and “The Federal Reserve and Monetary Policy”
- Chapter 28, “Aggregate Supply, Aggregate Demand, and Inflation: Putting It All Together”
- Chapter 32, “How Economies Grow and Develop”

NEOCLASSICAL EMPHASIS

- Chapter 7, “International Trade and Trade Policy,” Appendix
- Chapter 8, “Economic Behavior and Rationality,” Section 1
- Chapter 9, “Consumption and the Consumer Society,” Section 1 and Appendix
- Chapter 10, “Markets for Labor,” Appendix
- Chapter 17, “Markets Without Power,” Appendix
- Chapter 18, “Markets with Power,” Appendix

EMPHASIS ON CRITIQUES OF NEOCLASSICAL ECONOMICS

- Chapter 1, “Economic Activity in Context,” Section 2
- Chapter 2, “Useful Tools and Concepts,” Section 2
- Chapter 3, “Supply and Demand,” Section 5
- Chapter 7, “International Trade and Trade Policy,” Section 3
- Chapter 10, “Markets for Labor,” Section 5
- Chapter 17, “Markets Without Power,” Sections 1 and 5

WELFARE ANALYSIS EMPHASIS

- Chapter 6, “Welfare Analysis”
- Chapter 12, “Taxes and Tax Policy,” Section 1
- Chapter 13, “The Economics of the Environment,” Section 1 and Appendix

APPLIED MICROECONOMICS/POLICY EMPHASIS

- Chapter 5, “Welfare Analysis,” Section 5

- Chapter 7, “International Trade and Trade Policy,” Section 4
- Chapter 9, “Consumption and the Consumer Society,” Section 5
- Chapter 10, “Markets for Labor,” Sections 3 and 4
- Chapter 11, “Economic and Social Inequality,” Section 4
- Chapter 12, “Taxes and Tax Policy,” Sections 2 and 3
- Chapter 13, “The Economics of the Environment,” Sections 2 and 3
- Chapter 18, “Markets with Market Power,” Section 5

ECOLOGICAL EMPHASIS

- Chapter 9, “Consumption and the Consumer Society,” Section 4
- Chapter 13, “The Economics of the Environment”
- Chapter 14, “Common Property Resources and Public Goods,” Sections 3–5
- Chapter 15, “Capital Stocks and Resource Maintenance,” Section 2
- Chapter 21, “Macroeconomic Measurement: Social and Environmental Dimensions”
- Chapter 22, Section 1, “The Three Major Productive Sectors in an Economy,” and Section 2, “The Primary Sector in the United States”
- Chapter 33, “Growth and Sustainability in the Twenty-First Century”

GLOBAL EMPHASIS

- Chapter 7, “International Trade and Trade Policy”
- Chapter 29, “The Global Economy and Policy”
- Chapter 32, “How Economies Grow and Develop”
- Chapter 33, “Growth and Sustainability in the Twenty-First Century”

HUMAN DEVELOPMENT EMPHASIS

- Chapter 21, “Macroeconomic Measurement: Environmental and Social Dimensions”
- Chapter 32, “How Economies Grow and Develop”

STRUCTURAL EMPHASIS

- Chapter 22, “The Structure of the U.S. Economy”
- Chapter 30, “The Financial Crisis and the Great Recession”
- Chapter 31, “Deficits and Debt”

BEHAVIORAL ECONOMICS EMPHASIS

- Chapter 8, “Economic Actors and Rationality,” Sections 2 and 3
- Chapter 9, “Consumption and the Consumer Society,” Sections 3 and 5

KEYNESIAN/POST-KEYNESIAN/INSTITUTIONALIST EMPHASIS

- Chapter 19, “Introduction to Macroeconomics,” Sections 2 and 4
- Chapter 28, Appendix A3, “Post-Keynesian Macroeconomics”
- Chapter 30, “The Financial Crisis and the Great Recession”
- Chapter 31, “Deficits and Debt”
- Chapter 33, “Growth and Sustainability in the Twenty-First Century,” Section 5

MACRO-MODELING EMPHASIS

- Chapter 24, Appendix, “An Algebraic Approach to the Multiplier”
- Chapter 25, Appendix, “More Algebraic Approaches to the Multiplier”
- Chapter 28, Appendix “More Schools of Macroeconomics”

- Chapter 29, Section 4, “Macroeconomics in an Open Economy”
- Chapter 32, Section 1, “Development and Economic Growth”

MONEY AND FINANCE EMPHASIS

- Chapters 26 and 27, “Money, Banking and Finance,” and “The Federal Reserve and Monetary Policy”
- Chapter 30, “The Financial Crisis and the Great Recession”
- Chapter 31, “Deficits and Debt”

POVERTY/INEQUALITY/SOCIAL JUSTICE EMPHASIS

- Chapter 9, Consumption and the Consumer Society,” Section 3
- Chapter 10, “Markets for Labor,” Sections 4 and 5
- Chapter 11, “Economic and Social Inequality”
- Chapter 21, Section 2, “Why GDP Is Not a Measure of Well-Being,” Section 3, “Some Leading Approaches to Measuring Well-Being,” and Section 4, “Measuring Household Production”
- Chapter 23, Section 3, “Theories of Employment, Unemployment, and Wages”
- Chapter 32, Section 3, “Understanding Poverty” and Section 4, “Inequality”

CONTRASTING SCHOOLS OF THOUGHT EMPHASIS

- Chapter 19, “Introduction to Macroeconomics,” Section 4
- Chapter 28, Section 4, “Competing Theories,” and Appendix, “More Schools of Macroeconomics”
- Chapter 33, “Growth and Sustainability in the Twenty-First Century,” Section 5, “Are Stabilization and Sustainability in Conflict?”

PART

I

The Context for Economic Analysis

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Economics and Well-Being

What comes to your mind when you think of the word “economics”? Perhaps you think about things like money, the stock market, globalization, and supply-and-demand. These things are definitely important to our study of economics, and we will spend much of our time in this book studying these concepts.

But the goals of economics are about much more than these. As we will see in Chapter 1, economics is: *the study of how people manage their resources to meet their needs and enhance their well-being*. The term “well-being” can mean different things to different people. We take an inclusive approach to well-being in this book. Well-being depends on traditional economic indicators like our income and material standard of living. But our well-being also depends on many other issues, such as the quality of our environment, our leisure time, and our perceptions of fairness and justice. Our study of economics will help you better understand many of the outcomes that we observe and think about ways that we might be able to improve things. Many of the topics that we will study relate to current economic and political debates, such as economic inequality, the environment, taxes, and globalization.

The purpose of this introductory chapter is to provide an overview of some of the topics that we cover in more detail later in the book. Good data are essential for informed debates about how to enhance well-being in our communities. In this chapter, for each topic we provide a graphical representation of important data. We have tried to be as objective as possible by presenting a wide range of data from reliable sources. You may find some of this information surprising, as the results may differ from common perceptions and media representations.

The information in this chapter is divided into three sections: time trends, showing how a particular variable changes over time; bar graphs, showing data for different sections of the population or different industries; and bar graphs showing international comparisons. While we focus on the United States here, and in much of the rest of the book, it is important to see individual country data within the global context. If you are interested in the performance of specific countries we have not included here, detailed tables are available on the book’s companion website: www.gdae.org/principles.

The graphs that appear in this chapter are:

Time Trends

1. U.S. GDP per Capita
2. U.S. Unemployment Rate, 1960–Present
3. U.S. Inflation Rate, 1960–Present
4. Taxes as a Percentage of GDP
5. Stock Market Performance
6. Median Home Prices
7. Median Worker Earnings vs. Corporate Profits
8. Global International Trade
9. Global Carbon Dioxide Emissions

Bar Graphs for United States

- | | |
|--------------------------------------|-------------------------------------|
| 10. Income Inequality | 13. Educational Attainment |
| 11. Unequal Income Growth | 14. Industrial Concentration Ratios |
| 12. Gender-Based Earnings Inequality | |

International Comparisons

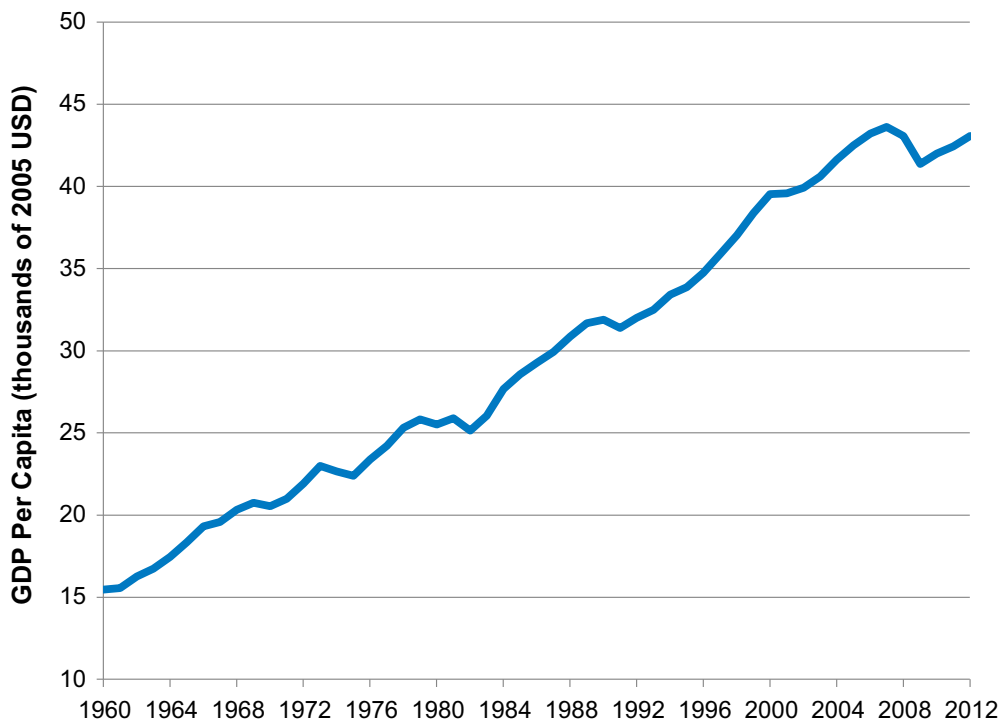
- | | |
|---|--|
| 15. GDP per Capita | 25. Income Inequality (Gini Coefficient) |
| 16. Recent Growth Rate of GDP per Capita | 26. CEO Pay vs. Worker Pay:
International Comparisons |
| 17. Net National Savings | 27. Absolute Poverty |
| 18. Government Debt | 28. Foreign Aid |
| 19. Labor Productivity | 29. Internet Users |
| 20. Average Annual Hours Worked | 30. Educational Performance |
| 21. Unemployment Rate (Percent of
Total Workforce) | 31. Life Expectancy |
| 22. Inflation | 32. Subjective Well-Being |
| 23. Total Tax Revenues (Percent of GDP) | 33. Carbon Dioxide Emissions per Capita |
| 24. Trade Balance (Percent of GDP) | 34. Local Air Quality |

International comparison rankings are based on the available data, including the highest and lowest values for each variable. While there are over 200 countries in the world, data are not available for all countries for each variable, so the number of countries ranked for each variable differs. The United States is shown in a different color. The rankings are presented with the “highest” at the top and the “lowest” at the bottom. However, this does not always mean that it is best to be at the top. For example, one of the graphs shows the percentage of people living in absolute poverty. Obviously, it is not a good thing to be ranked #1 for this variable.

1. U.S. GDP PER CAPITA

What it is: GDP, or Gross Domestic Product, is a measure of the total value of goods and services produced in a country. As discussed in Chapters 20 and 21, there are controversies about exactly what is covered, or not covered, by GDP, but the measure is used very widely as an index of the status and growth of an economy. GDP can be seen both as a measure of product and of income. GDP per capita, shown here, is GDP divided by the country's population, and the time trend of GDP/capita shows how average income changes over time.

The results: U.S. GDP per capita has increased nearly threefold since 1960. The progression has not been entirely smooth, with pauses and declines especially during periods of economic recession, but the overall trend is upwards. One of the largest breaks in this trend was the recent recession of 2007–9, discussed in detail in Chapter 23, 25, 28, and 30. As the graph shows, GDP/capita started to recover after 2010, but remained below its 2007 peak through 2012.

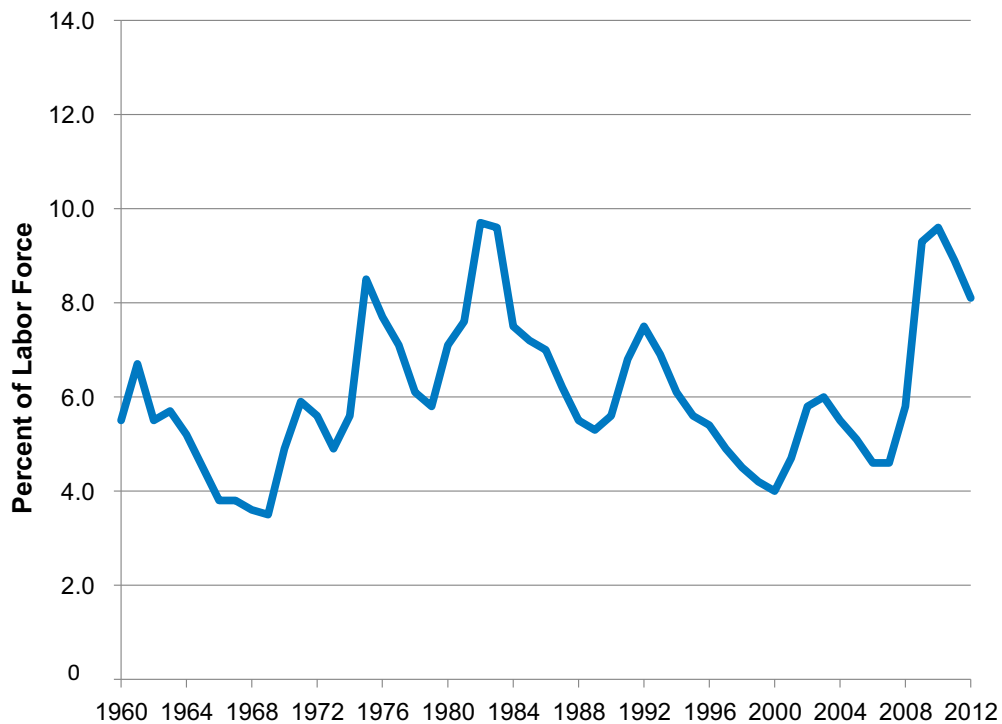


Source: World Bank, World Development Indicators database.

2. U.S. UNEMPLOYMENT RATE, 1960–PRESENT

What it is: The unemployment rate is a measure of the proportion of people in the labor force who are seeking jobs but unable to find them (discussed in detail in Chapter 23). The measure does not include people who have part-time work but would like full-time work, nor does it include “discouraged workers” who have given up looking for work. The unemployment rate typically falls during economic expansions, and rises during and immediately after economic recessions.

The results: U.S. unemployment has varied since 1960 between about 4 and 10 percent. In expansionary periods such as the late 1960s and the late 1990s, it was between 4 and 5 percent. In recessions it has typically risen above 6 percent, with peaks of between 8 and 10 percent in 1975, 1982, and 2010, resulting from severe recessions.

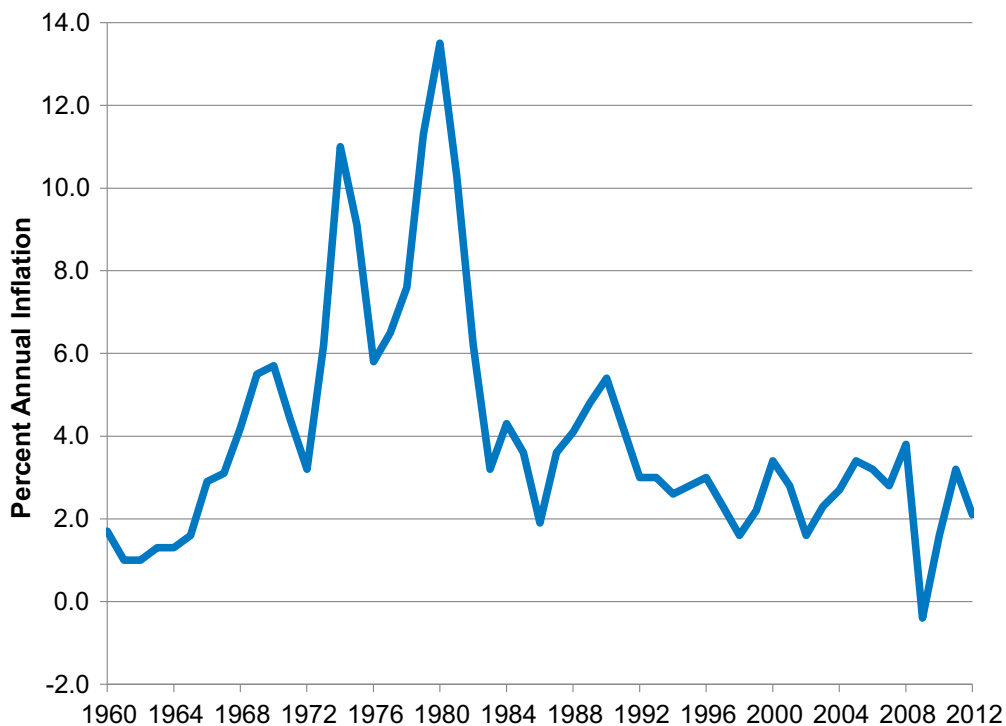


Source: U.S. Bureau of Labor Statistics, Current Population Survey, 2013.

3. U.S. INFLATION RATE, 1960–PRESENT

What it is: The inflation rate is a measure of the average increase in prices between one year and the next. It is measured by the change in the Consumer Price Index, discussed in Chapter 20. There are various versions of the Consumer Price Index (CPI); the graph below is based on the CPI-U, which measures the cost of living in urban areas.

The results: The U.S. inflation rate has varied considerably since 1960, with noticeable peaks in the late 1970s and early 1980s. At these times, the inflation rate rose above 10 percent (referred to as “double-digit inflation”). This level of inflation is considered significantly harmful to an economy, as discussed in Chapters 26–28. Since 1990, inflation rates in the United States have generally been fairly low, not rising above 4 percent, and averaging around 3 percent. During the 2007–9 recession, inflation briefly fell to zero, arousing concern about deflation—negative inflation or generally falling prices. (Although some might think that falling prices would be a good thing, sustained deflation can be very damaging to businesses and reduce employment, as occurred during the Great Depression of the 1930s.)

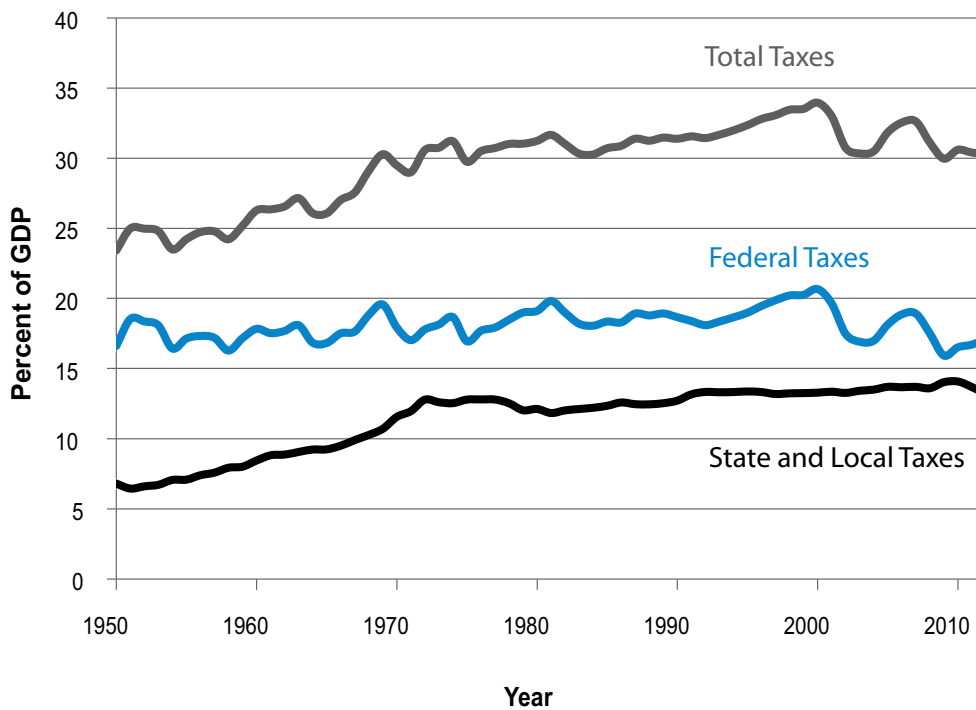


Source: U.S. Bureau of Labor Statistics, Consumer Price Index (CPI-U), 2013.

4. TAXES AS A PERCENTAGE OF GDP

What it is: The graph below shows tax collections in the United States over the period 1950–2012, measured as a percentage of gross domestic product (GDP). Total taxes are divided into federal taxes and state and local taxes.

The results: Total tax collections in the United States gradually increased from about 25% of GDP in the 1950s to close to 35% of GDP in the late 1990s. Since then, state and local tax collection has remained relatively constant, while federal tax collection has generally declined. Although in surveys many Americans say they believe taxes have increased in recent years (particularly federal taxes), the opposite is true. We discuss taxes in more detail in Chapter 12.

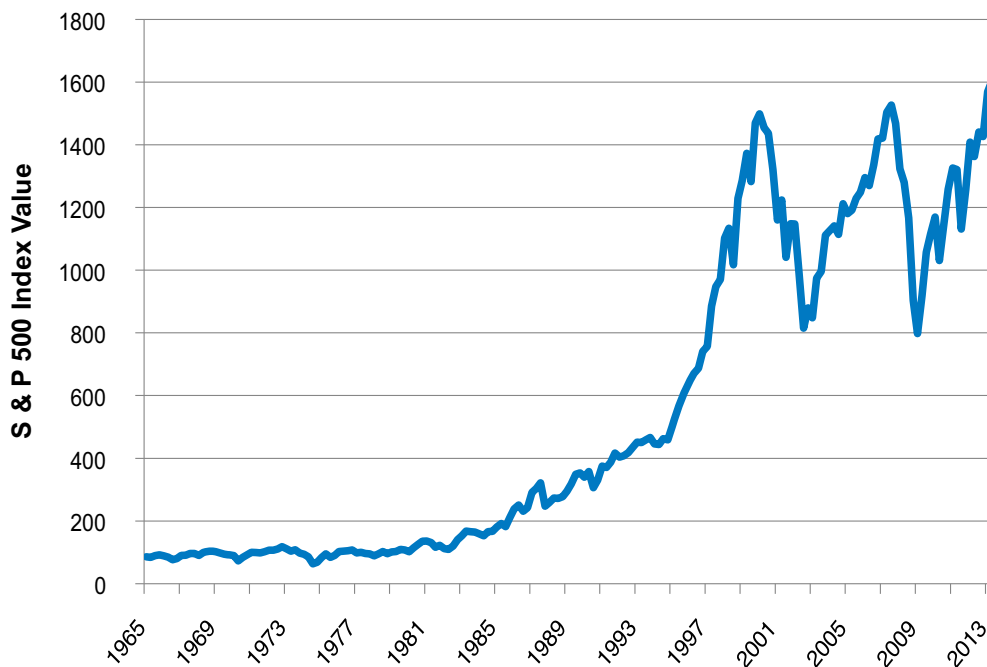


Source: U.S. Bureau of Economic Analysis, online database.

5. STOCK MARKET PERFORMANCE

What it is: Media stories about the economy often focus on the performance of the stock market. Several common stock indices, such as the Dow Jones Composite, the Nasdaq Composite, and S&P (Standard & Poor’s) 500 Index, provide a broad overview of stock market prices. The graph below shows the value of the S&P 500 Index from 1965 to mid-2013. The S&P 500 Index is calculated based on the stock prices of 500 large, mostly American, companies.

The results: From 1965 to 2000, the S&P 500 Index rose from about 100 to more than 1,500. Since 2000, two major “crashes” have taken place in the U.S. stock market. In each crash, the S&P 500 lost about half its value and then recovered to previous levels over several years. Although we do not discuss the stock market in much detail in this book, we spend considerable time discussing how markets operate, including the factors that lead to price fluctuations.



Source: St. Louis Federal Reserve Bank, S&P 500 Stock Price Index (SP500), <http://research.stlouisfed.org/fred2/series/SP500/downloaddata>.