

GWARTNEY • STROUP



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ECONOMICS

PRIVATE AND PUBLIC CHOICE

17E



THE EIGHT GUIDEPOSTS TO ECONOMIC THINKING

These eight guideposts provide the foundation for the economic way of thinking (they are discussed in Chapter 1). To do well in this course you will need to understand and be able to apply these ideas to a wide range of issues.

1. The use of scarce resources is costly; trade-offs must always be made.
2. Individuals choose purposefully — they try to get the most from their limited resources.
3. Incentives matter — choice is influenced in a predictable way by changes in incentives.
4. Individuals make decisions at the margin.
5. Although information can help us make better choices, its acquisition is costly.
6. Beware of the secondary effects: Economic actions often generate indirect as well as direct effects.
7. The value of a good or service is subjective.
8. The test of a theory is its ability to predict.

SPECIAL TOPICS

These Special Topics covered in the “Applying the Basics” section use the basic concepts to analyze important current-day topics.

1. Government Spending and Taxation
2. The Economics of Social Security
3. The Stock Market: Its Function, Performance, and Potential as an Investment Opportunity
4. Keynes and Hayek: Contrasting Views on Sound Economics and the Role of Government
5. The 2020 COVID-19 Recession: Cause, Response, and Implications for the Future
6. The Great Recession of 2008-2009: Causes and Response
7. Lessons from the Great Depression
8. The Economics of Health Care
9. Earnings Differences between Men and Women
10. Do Labor Unions Increase the Wages of Workers?
11. The Question of Resource Exhaustion
12. Difficult Environmental Cases and the Role of Government

KEYS TO ECONOMIC PROSPERITY

These keys to the economic prosperity of a nation are highlighted throughout the text.

- 1. Human Ingenuity.** Economic goods are the result of human ingenuity and action; thus, the size of the economic pie is variable, not fixed. [Chapter 2]
- 2. Private Ownership.** Private ownership provides people with a strong incentive to take care of things and develop resources in ways that are highly valued by others. [Chapter 2]
- 3. Gains from Trade.** Trade makes it possible for individuals to generate more output through specialization and division of labor, large-scale production processes, and the dissemination of improved products and production methods. [Chapter 2]
- 4. Invisible Hand Principle.** Market prices coordinate the actions of self-interested individuals and direct them toward activities that promote the general welfare. [Chapter 3]
- 5. Profits and Losses.** Profits direct producers toward activities that increase the value of resources; losses impose a penalty on those who reduce the value of resources. [Chapter 3]
- 6. Competition.** Competition motivates businesses to produce efficiently, cater to the views of consumers, and search for innovative improvements. [Chapter 22]
- 7. Entrepreneurship.** The entrepreneurial discovery and development of improved products and production processes is a central element of economic progress. [Chapter 23]
- 8. Productivity and Earnings.** In a market economy, productivity and earnings are closely linked. In order to earn a large income, one must provide large benefits to others. [Chapter 26]
- 9. Innovation and the Capital Market.** If the potential gains from innovative ideas and human ingenuity are going to be fully realized, it must be relatively easy for individuals to try their innovative and potentially ingenious ideas, but difficult to continue if the idea is a bad one. [Chapter 27]
- 10. Price Stability.** Maintenance of price stability is the essence of sound monetary policy; price stability provides the foundation for both economic stability and the efficient operation of markets. [Chapter 14]
- 11. International Trade.** When people are permitted to engage freely in international trade, they are able to achieve higher income levels and living standards than would otherwise be possible. [Chapter 18]
- 12. Role of Government.** Governments promote economic progress when they protect individuals and their property, enforce contracts impartially, provide access to money of stable value, avoid high taxes and excessive regulation, and foster competitive markets and free international trade. [Chapter 16]



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RELATIONSHIP BETWEEN MAIN EDITION AND THE MACRO/MICRO EDITIONS

In addition to the full length text, Microeconomic and Macroeconomic splits of this text are also available. The chapters and special topics covered by the micro and macro split versions are indicated in this table.

Chapters

ECONOMICS	MICROECONOMICS	MACROECONOMICS	
1	1	1	The Economic Approach
2	2	2	Some Tools of the Economist
3	3	3	Demand, Supply, and the Market Process
4	4	4	Demand and Supply: Applications and Extensions
5	5	5	Difficult Cases for the Market, and the Role of Government
6	6	6	The Economics of Political Action
7		7	Taking the Nation's Economic Pulse
8		8	Economic Fluctuations, Unemployment, and Inflation
9		9	An Introduction to Basic Macroeconomic Markets
10		10	Dynamic Change, Economic Fluctuations, and the AD-AS Model
11		11	Fiscal Policy: The Keynesian View and the Historical Development of Macroeconomics
12		12	Fiscal Policy, Incentives, and Secondary Effects
13		13	Money and the Banking System
14		14	Modern Macroeconomics and Monetary Policy
15		15	Macroeconomic Policy, Economic Stability, and the Federal Debt
16		16	Creating an Environment for Growth and Prosperity
17		17	The Economics of Development
18	16	18	Gaining from International Trade
19		19	International Finance and the Foreign Exchange Market
20	7		Consumer Choice and Elasticity
21	8		Costs and the Supply of Goods
22	9		Price Takers and the Competitive Process
23	10		Price-Searcher Markets with Low Entry Barriers
24	11		Price-Searcher Markets with High Entry Barriers
25	12		The Supply of and Demand for Productive Resources
26	13		Earnings, Productivity, and the Job Market
27	14		Investment, the Capital Market, and the Wealth of Nations
28	15		Income Inequality and Poverty

SPECIAL TOPICS

ECONOMICS	MICROECONOMICS	MACROECONOMICS	TOPIC TITLE
1	1	1	Government Spending and Taxation
2	2	2	The Economics of Social Security
3	3	3	The Stock Market: Its Function, Performance, and Potential as an Investment Opportunity
4	4	4	Keynes and Hayek: Contrasting Views on Sound Economics and the Role of Government
5	5	5	The 2020 COVID-19 Recession: Cause, Response, and Implications for the Future
6	6	6	The Great Recession of 2008–2009: Causes and Response
7	7	7	Lessons from the Great Depression
8	8		The Economics of Health Care
9	9		Earnings Differences between Men and Women
10	10		Do Labor Unions Increase the Wages of Workers?
11	11		The Question of Resource Exhaustion
12	12		Difficult Environmental Cases and the Role of Government

PREFACE

These are interesting times. Our lives have been shaken by a once-in-a-century worldwide pandemic, unemployment rates not seen since the Great Depression, racial unrest, and political uncertainty. Moreover, technology is altering how we communicate, learn, and interact with each other. Students are struggling to understand recent changes and their impact on their lives. Beginning with the first edition 45 years ago, our goal has been to use the tools of economics to explain how the real world works and to do so in a clear and understandable manner. This goal was at the forefront of our minds as we worked on this edition.

We have always used the tools of economics to analyze the operation of both the market and political processes. Both are central to the understanding of today's rapidly changing world. More than any other principles text, we highlight the roles of entrepreneurship, dynamic competition, and public choice analysis. Entrepreneurship is the key to understanding how markets work and the vast improvement in our living standards. Public choice is the key to understanding the structure of incentives confronted by voters, politicians, and bureaucrats and how this impacts political outcomes. This text examines both markets and political decision-making and indicates conditions under which each works well and alternative conditions that cause each to work poorly.

The micro chapters provide extensive coverage of entrepreneurship, innovation, and dynamic competition in the operation of markets. The macro chapters analyze the major alternative theories of both fiscal and monetary policy and provide up-to-date coverage of recent changes in Federal Reserve policy, government debt, and other factors impacting the macroeconomy. The "Beyond the Basics" Special Topics section includes features on micro topics such as the stock market, health care, and environmental economics as well as macro topics like the Great Depression, the Great Recession of 2008-2009, and the 2020 COVID-19 Recession.

ORGANIZATION AND INSTRUCTOR FLEXIBILITY

The organization of *Economics: Private and Public Choice* is designed to provide instructors with maximum flexibility. Those using the full-length text for a two-semester course can cover either microeconomics or macroeconomics first. As in recent editions, the text is divided into core chapters and a concluding special topics section. The 28 core chapters cover all of the material taught in most principles courses, and they are presented in the usual manner. Examples and data from the real world are used to reinforce the analysis. In addition, the "Beyond the Basics" Special Topics section includes 12 relatively short special topic applications covering both micro and macro topics. Features in this section address questions such as these: "How will the 2020 COVID-19 Recession impact our future?," "What caused the Great Depression?," "Is discrimination responsible for the earnings differences between men and women?," and "Are we running out of resources?" These features will grab the interest of students and are short enough to cover during a single class period. If you have not integrated the special topic materials into your course, please consider doing so. They will enrich your course and help students better understand the political economy debates that dominate the daily news of our world.

Instructors integrating public choice throughout their course will probably want to cover Chapters 5 and 6 before moving to the core micro or macro material. Others teaching a microeconomics course may want to jump from Chapter 4 directly to the core micro chapters. Correspondingly, some macroeconomics instructors will want to move directly

from Chapter 3 or 4 to the core macro material. The chapters have been written so that any of these options will work.

NEW MATERIAL IN THIS EDITION

New material designed to enliven economics and illustrate its relevance has been integrated into just about every chapter. The following are several of these additions:

The coverage of entrepreneurship and its importance as a source of new goods, services, and production methods that enrich our lives has been expanded in several chapters, including 2, 3, 16, 17, 22, 23, and 24. In addition, a new series, “Entrepreneurs Who Have Changed Our Lives,” is integrated into more than a dozen chapters. This series highlights both the contributions and interesting personal attributes of key entrepreneurs. While students will recognize several of the entrepreneurs in the series, others are relatively unknown. Jeff Bezos, Kendra Scott, Steve Jobs, Malcom McLean, Fred Smith, Oprah Winfrey, Sergey Brin, and Larry Page are among the entrepreneurs featured in the series. This feature will enhance the knowledge of students about how their lives are impacted by entrepreneurs.

Chapter 2 includes a new feature on “Are Scandinavian Countries Socialist?” The empirical evidence on this question is examined.

In Chapter 4, the analysis of the minimum wage, including the effect of recent increases in city and state minimums, has been updated and expanded.

Chapter 13 has been modified to reflect the recent changes in the operating procedures of the Federal Reserve, including the elimination of reserve requirements and substitution of interest payments to banks as the primary mechanism used to control bank reserves. The recent dramatic changes in the relationships between (a) bank reserves and checkable deposits, and (b) the monetary base and the money supply are also examined.

Chapter 14 examines the low interest rates of recent years and factors underlying those rates; it also analyzes their impact on both the economy and the conduct of monetary policy.

Chapter 15 examines the expanding federal debt, explains why it is so difficult to control, and analyzes the potential consequences of high levels of debt.

Chapters 16 and 17 on economic growth and development were revised extensively. These chapters highlight the fundamental causes of economic growth and provide analysis of the importance of economic institutions, climate and geography, history, demography, technology, investment, and changes in transportation and communication costs on the pattern of growth and development during the past 1000 years. Factors underlying the remarkable economic progress of developing countries during the past half-century are examined in detail. More than any other principles text, this edition reflects the modern view of economic growth and development.

Chapter 23 (Chapter 10 in the micro split) contains new material that examines how technological advances that have reduced search and transaction costs, including the growth of the ‘sharing economy,’ have altered the nature of markets and enabled entrepreneurs to break down traditional barriers to entry and expand competition.

Chapter 24 (Chapter 11 in the micro split) contains new material on dynamic competition in the digital age, including the impact of network effects and platform businesses. These two concepts help students understand the changing nature of markets and the growing presence of larger online firms. The impact of the sharing economy and the platform business model based on crowdsourced resources on the competitiveness of markets and choices available to consumers are examined. Improvements in technology, communications, and transportation have lowered transaction and monitoring costs, weakening the forces leading to diseconomies of scale. Marketing, advertising, and information costs have also changed in ways that make it easier to reach a larger customer base more rapidly and cost-effectively.

The new Special Topic 5 on the 2020 COVID-19 Recession examines the factors underlying the huge increase in unemployment and the severe economic downturn. The causes of the economic crisis, the policy response, and examination of how this recession differs from earlier ones are all discussed. This feature provides the foundation for future analysis of an economic event that is sure to attract student interest in the years immediately ahead.

ADDITIONAL TEXT FEATURES

Economics: Private and Public Choice retains several features that make the presentation of economics both more interesting and understandable.

- **Keys to Economic Prosperity.** Students often fail to appreciate the organizational and institutional factors that are the foundation for economic progress. To help remedy this situation, we have incorporated a “Keys to Economic Prosperity” feature that highlights the importance of factors like gains from trade, secure property rights, competition, and free trade as sources of economic prosperity. In all, 12 key factors that underlie modern economic prosperity are highlighted at appropriate places throughout the text; they also are listed inside the front cover.
- **Applications in Economics.** “Applications in Economics” boxes apply economic theory to real-world issues and controversies. These features illustrate the importance and power of the principles covered in the text.
- **Outstanding Economists.** Boxes throughout the text highlight the lives of major economists and focus on how their work has contributed to the development of economics.
- **Entrepreneurs Who Have Changed Our Lives.** This new series highlights both the economic contribution and personal attributes of key entrepreneurs. It will help students better understand the role of entrepreneurs and how their actions have contributed to the development of various goods and services that are often taken for granted.
- **Key Point Summaries.** At the end of each chapter, the Key Points section provides students with a concise statement of the material covered in the chapter (the chapter learning objectives).
- **Critical Analysis Questions.** Each chapter concludes with a set of analysis and discussion questions designed to test students’ ability to analyze economic issues and to apply economic theory to real-world events. Appendix B at the end of the text contains suggested answers for approximately a third of these questions.

SUPPLEMENTARY MATERIALS

The text is accompanied by a robust set of online learning tools designed to support your classroom work. MindTap includes real-time, interactive tutorials; online experiments; Graph Builder; A+ Test Prep; Graphing at a Glance; ConceptClips; Audio Cases with assessments; Concept & Application Videos; automatically graded quizzes; and automatically graded problem sets. Likewise, the book’s dynamic PowerPoint presentation has been further enhanced to facilitate your teaching.

FOR THE STUDENT

MindTap MindTap is a fully online, highly personalized learning experience built via Cengage Learning content that combines student learning tools—readings, multimedia, activities, and assessments—into a singular Learning Path that guides students through their course.

FOR THE INSTRUCTOR

We are sure that many of the features incorporated with this textbook will help you become a better teacher and make your classes more interesting to students. Personally, we have incorporated the Keys to Economic Prosperity series, economics video clips, homework assignments, and online quiz questions into our own classes with great success. The full set of supplements that can accompany the book include the following:

MindTap MindTap is a fully online, highly personalized learning experience built via Cengage Learning content that combines student learning tools—readings, multimedia, activities, and assessments—into a singular Learning Path that guides students through their course. Instructors personalize the experience by customizing authoritative Cengage Learning content and learning tools, including the ability to add their own content in the Learning Path via apps that integrate into the MindTap framework seamlessly with Learning Management Systems.

Interactive eBook In addition to interactive teaching and learning tools, Economic MindTap includes an interactive eBook. Students can take notes, highlight, search, and interact with embedded media specific to their book. Use it as a supplement to the printed text or as a substitute—with MindTap, the choice is up to your students.

Test Banks The test banks for the 17th edition were prepared by the author team with the assistance of Shannon Aucoin and other members of Cengage’s excellent team of subject matter experts. The authors have worked hard to update and improve the test banks for this edition. Joe Calhoun of Florida State University, was the primary author of the test bank for the last edition and the current version is reflective of this excellent work. The test bank contains approximately 6,000 questions—multiple choice and short answer. Within each chapter, the questions are tied to the major heads and specific topics within the chapter. Instructors who want to motivate their students to study will find online practice quizzes on MindTap that can easily be incorporated into their quizzes and exams. The cloud-based test banks for this edition have been enhanced significantly. Cognero contains all of the questions in the test bank so that you can create and customize tests in minutes. You can easily edit and import your own questions and graphics and edit and maneuver existing questions.

PowerPoint We believe our PowerPoint presentation, prepared by Joseph Connors of Florida Southern University, is the best you will find in the principles market. The presentation includes chapter-by-chapter lecture notes and hyperlinked slides of the exhibits included in the text. To facilitate classroom discussion and interaction, questions are strategically interspersed throughout the PowerPoint slides to help students develop the economic way of thinking. Instructions explaining how professors can easily add, delete, and modify slides in order to tailor the presentation to their liking are included. If instructors want to make the PowerPoint presentation available to students, they can place it on their website (or the site for their course).

Instructor’s Manual Information on how to use and modify the PowerPoint material is contained in the front of the Instructor’s Manual. The manual is divided by chapters, and each chapter begins with a detailed chapter outline in lecture-note form. It is designed to help instructors organize their notes to match the 17th edition of the book. Then there are focus questions which cover all the concepts in the chapter. Then the context of each chapter is given followed by important points and teaching suggestions. Each chapter also provides in-class economic games and experiments. Contributed in part by Professor Charles Stull of Kalamazoo College, the games are popular with many instructors. We hope you will try them.

The book companion Web site contains the key supplements designed to aid instructors, including the content from the Instructor’s Manual, test banks, and PowerPoint lecture and exhibit slides

A NOTE TO INSTRUCTORS

As we try to improve the book from one edition to the next, we rely heavily on our experiences as teachers. But our experience using the book is minuscule compared to that of the hundreds of instructors who use it nationwide. If you encounter problems or have

suggestions for improving the book, we urge you to let us know by writing to us in care of Cengage Learning, 5191 Natorp Blvd., Mason, OH 45040.

A NOTE TO STUDENTS

This textbook contains several features we think will help you maximize (a good economic term) the returns of your study efforts. Here are some of the things that will help you and a few tips for making the most of them.

- Each chapter begins with an opening page that indicates the central issues of the chapter. Before you read the chapter, briefly think about the questions the chapter will examine and how they relate to the material of prior chapters.
- The textbook is organized in the form of an outline. The headings within the text (in red) are the major points of the outline. Minor headings are subpoints under the major headings. In addition, important subpoints within sections are often set off and numbered. ***Bold italicized*** type is used to highlight material that is particularly important. Sometimes “thumbnail sketches” are included to recap material and help you keep the important points mentally organized.
- A “Key Points” summary appears at the end of each chapter. Use the summary as a checklist to determine whether you understand the major points of the chapter.
- A review of the exhibits and illustrative pictures will also provide you with a summary of the key points of each chapter. The accompanying captions briefly describe the economic phenomena illustrated by the exhibits.
- The key terms introduced in each chapter are defined in the margins. As you study the chapter, review the marginal definition of each key term as it is introduced. Later, you also may find it useful to review the marginal definitions. If you have forgotten the meaning of a term introduced earlier, consult the glossary at the end of the book.
- The critical analysis questions at the end of each chapter are intended to test your understanding of the economic way of thinking. Answering these questions and solving the problems will greatly enhance your knowledge of the material. Answers to approximately a third of these questions are provided in Appendix B.

If you need more practice, ask your professor about MindTap.

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