

# Contents

## PART I INTRODUCTION TO ECONOMICS 36

### Chapter 1: The Principles and Practice of Economics 36

#### 1.1 The Scope of Economics 37

Economic Agents and Economic Resources	37
Definition of Economics	38
Positive Economics and Normative Economics	39
Microeconomics and Macroeconomics	40

#### 1.2 Three Principles of Economics 40

#### 1.3 The First Principle of Economics: Optimization 41

Trade-offs and Budget Constraints	42
Opportunity Cost	43
Cost-Benefit Analysis	44

**Evidence-Based Economics:** Is Facebook free? 45

#### 1.4 The Second Principle of Economics: Equilibrium 47

The Free-Rider Problem	48
------------------------	----

#### 1.5 The Third Principle of Economics: Empiricism 49

#### 1.6 Is Economics Good for You? 49

Summary	50
Key Terms	51
Questions	51
Evidence-Based Economics Problems	51
Problems	52

### Chapter 2: Economic Science: Using Data and Models to Understand the World 54

#### 2.1 The Scientific Method 55

Models and Data	56
An Economic Model	57

**Evidence-Based Economics:** How much more does a worker with a 4-year college degree earn compared to a worker with a high school degree? 58

Means and Medians	60
Argument by Anecdote	60

#### 2.2 Causation and Correlation 61

The Red Ad Blues	61
Causation Versus Correlation	61

**Choice & Consequence:** Spend Now and Pay Later? 64

Experimental Economics and Natural Experiments	64
--	----

**Evidence-Based Economics:** What is the return to education? 65

#### 2.3 Economic Questions and Answers 66

Summary	68
Key Terms	68
Questions	68
Evidence-Based Economics Problems	69
Problems	69

#### Appendix: Constructing and Interpreting Charts and Graphs 71

A Study about Incentives	71
Experimental Design	71
Describing Variables	72
Cause and Effect	74
Appendix Key Terms	77
Appendix Problems	77

### Chapter 3: Optimization: Trying to Do the Best You Can 78

#### 3.1 Optimization: Trying to Choose the Best Feasible Option 79

**Choice & Consequence:** Do People Actually Choose the Best Feasible Option? 80

#### 3.2 Optimization Application: Renting the Optimal Apartment 80

Before and After Comparisons	83
------------------------------	----

#### 3.3 Optimization Using Marginal Analysis 84

Marginal Cost	85
---------------	----

**Evidence-Based Economics:** How does location affect the rental cost of housing? 88

Summary	91
Key Terms	92
Questions	92
Evidence-Based Economics Problems	92
Problems	92

## Chapter 4: Demand, Supply, and Equilibrium **96**

### 4.1 Markets **97**

Competitive Markets 98

### 4.2 How Do Buyers Behave? **99**

Demand Curves 100

Willingness to Pay 100

From Individual Demand Curves to Aggregated Demand Curves 101

Building the Market Demand Curve 102

Shifting the Demand Curve 103

**Evidence-Based Economics:** How much more gasoline would people buy if its price were lower? 105

### 4.3 How Do Sellers Behave? **107**

Supply Curves 107

Willingness to Accept 107

From the Individual Supply Curve to the Market Supply Curve 108

Shifting the Supply Curve 109

### 4.4 Supply and Demand in Equilibrium **111**

Curve Shifting in Competitive Equilibrium 113

**Letting the Data Speak:** Technological Breakthroughs Drive Down the Equilibrium Price of Oil 114

**Letting the Data Speak:** The Day Oil Became Garbage 115

### 4.5 What Would Happen If the Government Tried to Dictate the Price of Gasoline? **116**

**Choice & Consequence:** The Unintended Consequences of Fixing Market Prices 118

Summary 119

Key Terms 120

Questions 120

Evidence-Based Economics Problems 121

Problems 121

## PART II FOUNDATIONS OF MICROECONOMICS **124**

## Chapter 5: Consumers and Incentives **124**

### 5.1 The Buyer's Problem **125**

What You Like 125

Prices of Goods and Services 126

How Much Money You Have to Spend 126

**Choice & Consequence:** Absolutes Versus Percentages 126

### 5.2 Putting It All Together **128**

Price Changes 130

**Letting the Data Speak:** Does \$6 + \$1

Always = \$7? 131

Income Changes 131

### 5.3 From the Buyer's Problem to the Demand Curve **132**

### 5.4 Consumer Surplus **133**

An Empty Feeling: Loss in Consumer Surplus When Price Increases 134

**Evidence-Based Economics:** Would a smoker quit the habit for \$100 per month? 135

### 5.5 Demand Elasticities **138**

The Price Elasticity of Demand 138

The Cross-Price Elasticity of Demand 143

The Income Elasticity of Demand 144

**Letting the Data Speak:** Should McDonald's Be Interested in Elasticities? 145

Summary 145

Key Terms 146

Questions 146

Evidence-Based Economics Problems 147

Problems 148

## Appendix: Representing Preferences with Indifference Curves: Another Use of the Budget Constraint **150**

Appendix Questions 153

Appendix Key Terms 153

## Chapter 6: Sellers and Incentives **154**

### 6.1 Sellers in a Perfectly Competitive Market **155**

### 6.2 The Seller's Problem **155**

Making the Goods: How Inputs Are Turned into Outputs 156

The Cost of Doing Business: Introducing Cost Curves 157

The Rewards of Doing Business: Introducing Revenue Curves 160

Putting It All Together: Using the Three Components to Do the Best You Can 161

**Choice & Consequence:** Maximizing Total Profit, Not Per-Unit Profit 163

### 6.3 From the Seller's Problem to the Supply Curve **164**

Price Elasticity of Supply 164

Shutdown 165

**Choice & Consequence:** Marginal Decision Makers Ignore Sunk Costs 167

### 6.4 Producer Surplus **167**

### 6.5 From the Short Run to the Long Run **169**

Long-Run Supply Curve 170

<b>Choice &amp; Consequence:</b> Visiting a Car Manufacturing Plant	170
<b>6.6 From the Firm to the Market: Long-Run Competitive Equilibrium</b>	<b>171</b>
Firm Entry	171
Firm Exit	173
Zero Profits in the Long Run	173
Economic Profit Versus Accounting Profit	174
<b>Letting the Data Speak:</b> The Effect of Uber Driver Entry in the Long Run	175
<b>Evidence-Based Economics:</b> How would an ethanol subsidy affect ethanol producers?	176
Summary	179
Key Terms	179
Questions	180
Evidence-Based Economics Problems	181
Problems	181
<b>Appendix: When Firms Have Different Cost Structures</b>	<b>184</b>

## **Chapter 7: Perfect Competition and the Invisible Hand** **186**

<b>7.1 Perfect Competition and Efficiency</b>	<b>187</b>
Social Surplus	188
Pareto Efficiency	190
<b>7.2 Extending the Reach of the Invisible Hand: From the Individual to the Firm</b>	<b>190</b>
<b>7.3 Extending the Reach of the Invisible Hand: Allocation of Resources Across Industries</b>	<b>194</b>
<b>Letting the Data Speak:</b> Adam Smith Visits the White House	197
<b>7.4 Prices Guide the Invisible Hand</b>	<b>197</b>
Deadweight Loss	199
<b>Evidence-Based Economics:</b> Do companies like Uber make use of the invisible hand?	200
The Command Economy	204
<b>Choice &amp; Consequence:</b> FEMA and Walmart After Katrina	205
The Central Planner	206
<b>Choice &amp; Consequence:</b> Command and Control at Kmart	207
<b>7.5 Equity and Efficiency</b>	<b>208</b>
<b>Evidence-Based Economics:</b> Can markets composed of only self-interested people maximize the overall well-being of society?	209
Summary	212
Key Terms	212
Questions	212
Evidence-Based Economics Problems	213
Problems	214

## **Chapter 8: Trade** **216**

<b>8.1 The Production Possibilities Curve</b>	<b>217</b>
Calculating Opportunity Cost	219
<b>8.2 The Basis for Trade: Comparative Advantage</b>	<b>220</b>
Specialization	221
Absolute Advantage	221
<b>Choice &amp; Consequence:</b> An Experiment on Comparative Advantage	222
The Price of the Trade	223
<b>8.3 Trade Between States</b>	<b>224</b>
<b>Choice &amp; Consequence:</b> Should LeBron James Paint His Own House?	225
Economy-Wide PPC	226
Comparative Advantage and Specialization Among States	227
<b>8.4 Trade Between Countries</b>	<b>228</b>
Determinants of Trade Between Countries	230
Exporting Nations: Winners and Losers	231
<b>Letting the Data Speak:</b> Fair Trade Products	231
Importing Nations: Winners and Losers	233
Where Do World Prices Come From?	234
Determinants of a Country's Comparative Advantage	234
<b>8.5 Arguments Against Free Trade</b>	<b>234</b>
National Security Concerns	234
Fear of Globalization	235
Environmental and Resource Concerns	235
Infant Industry Arguments	235
The Effects of Tariffs	236
<b>Choice &amp; Consequence:</b> Tariffs Affect Trade Between Firms	237
<b>Evidence-Based Economics:</b> Will free trade cause you to lose your job?	238
Summary	240
Key Terms	240
Questions	240
Evidence-Based Economics Problems	241
Problems	242

## **Chapter 9: Externalities and Public Goods** **244**

<b>9.1 Externalities</b>	<b>245</b>
A "Broken" Invisible Hand: Negative Externalities	246
A "Broken" Invisible Hand: Positive Externalities	248
Pecuniary Externalities	250
<b>Choice &amp; Consequence:</b> Coronavirus Vaccination: Positive Externalities in Spots You Never Imagined	250

<b>9.2 Private Solutions to Externalities</b>	<b>251</b>	<b>10.2 Regulation</b>	<b>289</b>
Private Solution: Bargaining	251	Direct Regulation	289
The Coase Theorem	252	<b>10.3 Government Failures</b>	<b>292</b>
Private Solution: Doing the Right Thing	253	The Direct Costs of Bureaucracies	293
<b>9.3 Government Solutions to Externalities</b>	<b>254</b>	Corruption	293
Government Regulation: Command-and-Control Policies	254	Underground Economy	293
<b>Evidence-Based Economics:</b> How did the government lower the number of earthquakes in Oklahoma?	255	<b>Choice &amp; Consequence:</b> Can Market Regulation Save Rhinos from Extinction?	294
Government Regulation: Market-Based Approaches	257	<b>10.4 Equity Versus Efficiency</b>	<b>295</b>
Corrective Taxes	257	<b>10.5 Consumer Sovereignty and Paternalism</b>	<b>297</b>
Corrective Subsidies	258	The Debate	297
<b>Letting the Data Speak:</b> How to Value Externalities	259	<b>Evidence-Based Economics:</b> What is the optimal size of government?	298
<b>Letting the Data Speak:</b> Pay as You Throw: Consumers Create Negative Externalities Too!	260	<b>Letting the Data Speak:</b> The Efficiency of Government Versus Privately Run Expeditions	300
<b>9.4 Public Goods</b>	<b>260</b>	<b>Choice &amp; Consequence:</b> Taxation and Innovation	300
Government Provision of Public Goods	262	<i>Summary</i>	301
<b>Choice &amp; Consequence:</b> The Free-Rider's Dilemma	262	<i>Key Terms</i>	301
Private Provision of Public Goods	264	<i>Questions</i>	301
<b>9.5 Common Pool Resource Goods</b>	<b>266</b>	<i>Evidence-Based Economics Problems</i>	302
<b>Choice &amp; Consequence:</b> Tragedy of the Commons	267	<i>Problems</i>	302
<b>Choice &amp; Consequence:</b> The Race to Fish	268	<b>Chapter 11: Markets for Factors of Production</b>	<b>306</b>
<b>Evidence-Based Economics:</b> How can the Queen of England lower her commute time to Wembley Stadium?	269	<b>11.1 The Competitive Labor Market</b>	<b>307</b>
<i>Summary</i>	270	The Demand for Labor	308
<i>Key Terms</i>	271	<b>11.2 The Supply of Labor: Your Labor-Leisure Trade-Off</b>	<b>310</b>
<i>Questions</i>	271	Labor Market Equilibrium: Supply Meets Demand	312
<i>Evidence-Based Economics Problems</i>	271	Labor Demand Shifters	312
<i>Problems</i>	272	<b>Choice &amp; Consequence:</b> Producing Web Sites and Computer Programs	312
<b>Chapter 10: The Government in the Economy: Taxation and Regulation</b>	<b>274</b>	<b>Letting the Data Speak:</b> "Get Your Hot Dogs Here!"	313
<b>10.1 Taxation and Government Spending in the United States</b>	<b>275</b>	Factors That Shift Labor Supply	314
Where Does the Money Come From?	276	<b>Letting the Data Speak:</b> Do Wages Really Go Down If Labor Supply Increases?	315
Why Does the Government Tax and Spend?	278	<b>11.3 Wage Inequality</b>	<b>316</b>
<b>Choice &amp; Consequence:</b> The Government Budget Constraint	279	Differences in Human Capital	316
<b>Letting the Data Speak:</b> Understanding Federal Income Tax Brackets	280	Differences in Compensating Wage Differentials	317
<b>Letting the Data Speak:</b> Reducing Inequality the Scandinavian Way	283	<b>Choice &amp; Consequence:</b> Paying for Worker Training	317
Taxation: Tax Incidence and Deadweight Losses	284	Discrimination in the Job Market	318
<b>Choice &amp; Consequence:</b> The Deadweight Loss Depends on the Tax	287	Changes in Wage Inequality over Time	319
		<b>Choice &amp; Consequence:</b> Compensating Wage Differentials	320
		<b>Letting the Data Speak:</b> Broadband and Inequality	321

**11.4 The Market for Other Factors of Production: Physical Capital and Land 322**

**Letting the Data Speak:** The Top 1 Percent Share and Capital Income 323

**Evidence-Based Economics:** Is there discrimination in the labor market? 325

Summary 326

Key Terms 327

Questions 327

Evidence-Based Economics Problems 327

Problems 328

**Appendix: Monopsony in the Labor Market 330**

**PART III MARKET STRUCTURE 332**

**Chapter 12: Monopoly 332**

**12.1 Introducing a New Market Structure 333**

**12.2 Sources of Market Power 333**

Legal Market Power 334

Natural Market Power 334

Control of Key Resources 335

**Choice & Consequence:** Barriers to Entry Lurk Everywhere 335

Economies of Scale 336

**12.3 The Monopolist's Problem 337**

Revenue Curves 338

Price, Marginal Revenue, and Total Revenue 340

**12.4 Choosing the Optimal Quantity and Price 341**

Producing the Optimal Quantity 341

Setting the Optimal Price 342

How a Monopolist Calculates Profits 343

Does a Monopoly Have a Supply Curve? 344

**12.5 The "Broken" Invisible Hand: The Cost of Monopoly 344**

**12.6 Restoring Efficiency 346**

Three Degrees of Price Discrimination 347

**Letting the Data Speak:** Third-Degree Price Discrimination in Action 349

**12.7 Government Policy Toward Monopoly 349**

The Microsoft Case 350

Price Regulation 351

**Evidence-Based Economics:** Can a monopoly ever be good for society? 351

Summary 354

Key Terms 354

Questions 354

Evidence-Based Economics Problems 355

Problems 355

**Chapter 13: Game Theory and Strategic Play 358**

**13.1 Simultaneous-Move Games 359**

Best Responses and the Prisoners' Dilemma 360

Dominant Strategies and Dominant Strategy Equilibrium 361

Games Without Dominant Strategies 361

**13.2 Nash Equilibrium 363**

Finding a Nash Equilibrium 364

**Choice & Consequence:** Work or Surf? 365

**13.3 Applications of Nash Equilibria 365**

Tragedy of the Commons Revisited 366

Zero-Sum Games 366

**13.4 How Do People Actually Play Such Games? 368**

Game Theory in Penalty Kicks 368

**Evidence-Based Economics:** Is there value in putting yourself in someone else's shoes? 369

**13.5 Extensive-Form Games 371**

Backward Induction 372

First-Mover Advantage, Commitment, and Vengeance 373

**Evidence-Based Economics:** Is there value in putting yourself in someone else's shoes in extensive-form games? 374

**Choice & Consequence:** There Is More to Life Than Money 377

Summary 378

Key Terms 378

Questions 378

Evidence-Based Economics Problems 379

Problems 379

**Chapter 14: Oligopoly and Monopolistic Competition 382**

**14.1 Two More Market Structures 383**

**14.2 Oligopoly 384**

The Oligopolist's Problem 385

Oligopoly Model with Homogeneous Products 385

Doing the Best You Can: How Should You Price to Maximize Profits? 386

Oligopoly Model with Differentiated Products 387

**Letting the Data Speak:** Airline Price Wars 389

Collusion: Another Way to Keep Prices High 389

**Letting the Data Speak:** Apple Versus Samsung 390

**Letting the Data Speak:** To Cheat or Not to Cheat: That Is the Question 392

**Choice & Consequence:** Collusion in Practice 394

<b>14.3 Monopolistic Competition</b>	<b>394</b>	<b>15.5 Risk Preferences</b>	<b>424</b>
The Monopolistic Competitor's Problem	394	Summary	425
Doing the Best You Can: How a Monopolistic Competitor Maximizes Profits	395	Key Terms	426
<b>Letting the Data Speak:</b> Why Do Some Firms Advertise and Some Don't?	396	Questions	426
How a Monopolistic Competitor Calculates Profits	396	Evidence-Based Economics Problem	426
Long-Run Equilibrium in a Monopolistically Competitive Industry	397	Problems	426
<b>14.4 The "Broken" Invisible Hand</b>	<b>399</b>	<b>Chapter 16: The Economics of Information</b>	<b>428</b>
Regulating Market Power	400	<b>16.1 Asymmetric Information</b>	<b>429</b>
<b>14.5 Summing Up: Four Market Structures</b>	<b>401</b>	Hidden Characteristics: Adverse Selection in the Used Car Market	430
<b>Letting the Podcast Speak:</b> A Surprising Duopoly: Democrats and Republicans	402	Hidden Characteristics: Adverse Selection in the Health Insurance Market	431
<b>Evidence-Based Economics:</b> How many firms are necessary to make a market competitive?	403	Market Solutions to Adverse Selection: Signaling	432
Summary	405	<b>Choice &amp; Consequence:</b> Are You Earning a Signal Right Now?	433
Key Terms	405	<b>Evidence-Based Economics:</b> Why do new cars lose considerable value the minute they are driven off the lot?	433
Questions	405	<b>Choice &amp; Consequence:</b> A Tale of a Tail	435
Evidence-Based Economics Problems	406	<b>16.2 Hidden Actions: Markets with Moral Hazard</b>	<b>435</b>
Problems	406	<b>Letting the Data Speak:</b> Moral Hazard on Your Bike	436
<b>PART IV EXTENDING THE MICROECONOMIC TOOLBOX</b>	<b>410</b>	Market Solutions to Moral Hazard in the Labor Market: Efficiency Wages	436
<b>Chapter 15: Trade-offs Involving Time and Risk</b>	<b>410</b>	<b>Letting the Podcast Speak:</b> Tackling Adverse Selection and Moral Hazard in the Workplace	437
<b>15.1 Modeling Time and Risk</b>	<b>411</b>	Market Solutions to Moral Hazard in the Insurance Market: "Putting Your Skin in the Game"	438
<b>15.2 The Time Value of Money</b>	<b>412</b>	<b>Letting the Data Speak:</b> Designing Incentives for Teachers	438
Future Value and the Compounding of Interest	412	<b>Evidence-Based Economics:</b> Why is private health insurance so expensive?	439
Borrowing Versus Lending	414	<b>16.3 Government Policy in a World of Asymmetric Information</b>	<b>440</b>
Present Value and Discounting	415	Government Intervention and Moral Hazard	441
<b>15.3 Time Preferences</b>	<b>417</b>	The Equity-Efficiency Trade-off	442
Time Discounting	417	Crime and Punishment as a Principal-Agent Problem	442
Preference Reversals	418	<b>Letting the Data Speak:</b> Moral Hazard Among Job Seekers	442
<b>Choice &amp; Consequence:</b> Failing to Anticipate Preference Reversals	419	Summary	443
<b>Evidence-Based Economics:</b> Do people exhibit a preference for immediate gratification?	419	Key Terms	443
<b>15.4 Probability and Risk</b>	<b>420</b>	Questions	443
Roulette Wheels and Probabilities	420	Evidence-Based Economics Problems	444
Independence and the Gambler's Fallacy	421	Problems	444
<b>Letting the Data Speak:</b> Roulette Wheels and Elections	421		
Expected Value	422		
Extended Warranties	423		
<b>Choice &amp; Consequence:</b> Is Gambling Worthwhile?	423		

## Chapter 17: Auctions and Bargaining 446

<b>17.1 Auctions</b>	<b>448</b>
Types of Auctions	449
Open Outcry: English Auctions	450
<b>Letting the Data Speak:</b> To Snipe or Not to Snipe?	451
Open Outcry: Dutch Auctions	451
Sealed Bid: First-Price Auctions	453
Sealed Bid: Second-Price Auctions	453
The Revenue Equivalence Theorem	455
<b>Evidence-Based Economics:</b> How should you bid in an eBay auction?	456
<b>17.2 Bargaining</b>	<b>457</b>
What Determines Bargaining Outcomes?	457
Bargaining in Action: The Ultimatum Game	458
Bargaining and the Coase Theorem	460
<b>Evidence-Based Economics:</b> Who determines how the household spends its money?	461
<b>Letting the Data Speak:</b> Sex Ratios Change Bargaining Power Too	463
Summary	463
Key Terms	463
Questions	464
Evidence-Based Economics Problems	464
Problems	465

## Chapter 18: Social Economics 468

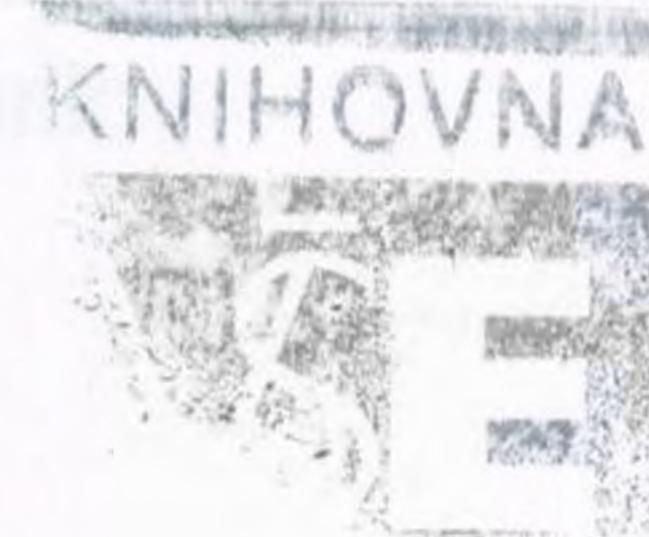
<b>18.1 The Economics of Charity and Fairness</b>	<b>469</b>
The Economics of Charity	469
<b>Letting the Data Speak:</b> Do People Donate Less When It's Costlier to Give?	471
<b>Letting the Data Speak:</b> Why Do People Give to Charity?	472
The Economics of Fairness	473
<b>Letting the Data Speak:</b> Dictators in the Lab	476
<b>Evidence-Based Economics:</b> Do people care about fairness?	476
<b>18.2 The Economics of Trust and Revenge</b>	<b>478</b>
The Economics of Trust	478
The Economics of Revenge	480
<b>Choice &amp; Consequence:</b> Does Revenge Have an Evolutionary Logic?	481
<b>Letting the Podcast Speak:</b> Sorry! I Should Apologize, but How?	482
<b>18.3 How Others Influence Our Decisions</b>	<b>482</b>
Where Do Our Preferences Come From?	482

The Economics of Peer Effects	483
<b>Letting the Data Speak:</b> Is Economics Bad for You?	483
Following the Crowd: Herding	484
<b>Letting the Data Speak:</b> Your Peers Affect Your Waistline	485
<b>Choice &amp; Consequence:</b> Are You an Internet Explorer?	486
Summary	487
Key Terms	487
Questions	487
Evidence-Based Economics Problems	488
Problems	488

## PART V INTRODUCTION TO MACROECONOMICS 490

### Chapter 19: The Wealth of Nations: Defining and Measuring Macroeconomic Aggregates 490

<b>19.1 Macroeconomic Questions</b>	<b>491</b>
<b>19.2 National Income Accounts: Production = Expenditure = Income</b>	<b>493</b>
Production	493
Expenditure	494
Income	494
Circular Flows	495
National Income Accounts: Production	496
National Income Accounts: Expenditure	498
<b>Evidence-Based Economics:</b> In the United States, what is the total market value of annual economic production?	500
<b>Letting the Data Speak:</b> Saving versus Investment	502
National Income Accounting: Income	503
<b>19.3 What Isn't Measured by GDP?</b>	<b>503</b>
Physical Capital Depreciation	504
Home Production	504
The Underground Economy	505
Externalities	506
Gross Domestic Product versus Gross National Product	506
The Increase in Income Inequality	507
Leisure	507
Does GDP Buy Happiness?	508
<b>19.4 Real versus Nominal</b>	<b>509</b>
The GDP Deflator	511
The Consumer Price Index	513



Inflation	514
Adjusting Nominal Variables	514
Summary	515
Key Terms	515
Questions	516
Evidence-Based Economics Problems	516
Problems	517

## Chapter 20: Aggregate Incomes 520

### 20.1 Inequality Around the World 521

Measuring Differences in GDP per Capita	521
---	-----

#### Letting the Data Speak: The Big Mac

Index	523
-------	-----

Cross-Country Differences in GDP per capita	523
---	-----

GDP per Worker	524
----------------	-----

Productivity	525
--------------	-----

Incomes and the Standard of Living	526
------------------------------------	-----

#### Choice & Consequence: Dangers of Just

Focusing on GDP per Capita	527
----------------------------	-----

### 20.2 Productivity and the Aggregate

#### Production Function 528

Productivity Differences	529
--------------------------	-----

The Aggregate Production Function	529
-----------------------------------	-----

Labor	530
-------	-----

Physical Capital and Land	530
---------------------------	-----

Technology	530
------------	-----

Representing the Aggregate Production Function	530
--	-----

### 20.3 The Role and Determinants of

#### Technology 532

Technology	532
------------	-----

Dimensions of Technology	533
--------------------------	-----

Letting the Data Speak: Moore's Law	534
-------------------------------------	-----

#### Choice & Consequence: Academic

Misallocation in Nazi Germany	535
-------------------------------	-----

#### Letting the Data Speak: Efficiency of

Production and Productivity at the	535
------------------------------------	-----

Company Level	535
---------------	-----

Entrepreneurship	536
------------------	-----

#### Letting the Data Speak: Monopoly

and GDP	536
---------	-----

#### Evidence-Based Economics: Why is the

average American so much richer than the	537
--	-----

average Indian?	537
-----------------	-----

Summary	539
---------	-----

Key Terms	539
-----------	-----

Questions	539
-----------	-----

Evidence-Based Economics Problems	540
-----------------------------------	-----

Problems	540
----------	-----

## Appendix: The Mathematics of Aggregate Production Functions 543

## PART VI LONG-RUN GROWTH AND DEVELOPMENT 546

### Chapter 21: Economic Growth 546

#### 21.1 The Power of Economic Growth 547

A First Look at U.S. Growth	547
-----------------------------	-----

Exponential Growth	549
--------------------	-----

#### Choice & Consequence: The Power of

Exponential Growth	550
--------------------	-----

Patterns of Growth	551
--------------------	-----

#### Letting the Data Speak: Levels versus

Growth	554
--------	-----

#### 21.2 How Does a Nation's Economy Grow? 556

Optimization: The Choice Between Saving and	556
---	-----

Consumption	556
-------------	-----

What Brings Sustained Growth?	557
-------------------------------	-----

#### Choice & Consequence: Is Increasing the

Saving Rate Always a Good Idea?	558
---------------------------------	-----

Knowledge, Technological Change, and Growth	558
---	-----

#### Letting the Data Speak: Technology and

Life Expectancy	560
-----------------	-----

#### 21.3 The History of Growth and Technology 560

Growth Before Modern Times	560
----------------------------	-----

#### Letting the Data Speak: The Great

Productivity Puzzle	561
---------------------	-----

#### Evidence-Based Economics: Why are you so

much more prosperous than your great-great-	562
---	-----

grandparents were?	562
--------------------	-----

Malthusian Limits to Growth	565
-----------------------------	-----

The Industrial Revolution	565
---------------------------	-----

Growth and Technology Since the Industrial	566
--	-----

Revolution	566
------------	-----

#### 21.4 Growth, Inequality, and Poverty 566

Growth and Inequality	566
-----------------------	-----

Growth and Poverty	566
--------------------	-----

#### Letting the Data Speak: Income Inequality

in the United States	567
----------------------	-----

#### Choice & Consequence: Inequality versus

Poverty	568
---------	-----

How Can We Reduce Poverty?	569
----------------------------	-----

Summary	570
---------	-----

Key Terms	570
-----------	-----

Questions	570
-----------	-----

Evidence-Based Economics Problems	571
-----------------------------------	-----

Problems	571
----------	-----

#### Appendix: The Solow Growth Model 573

The Three Building Blocks of the	573
----------------------------------	-----

Solow Model	573
-------------	-----

Steady-State Equilibrium in the	574
---------------------------------	-----

Solow Model	574
-------------	-----



Determinants of GDP	575	Calculating the Unemployment Rate	610
Dynamic Equilibrium in the Solow Model	577	Trends in the Unemployment Rate	611
Sources of Growth in the Solow Model	578	<b>23.2 Equilibrium in the Labor Market</b>	<b>612</b>
Calculating Average (Compound)		The Demand for Labor	612
Growth Rates	579	Shifts in the Labor Demand Curve	614
<i>Appendix Key Terms</i>	581	The Supply of Labor	615
<i>Appendix Problems</i>	581	Shifts in the Labor Supply Curve	616
		<b>Letting the Data Speak:</b> Who Is Unemployed?	617
<b>Chapter 22: Why Isn't the Whole World Developed?</b>	<b>582</b>	<b>Letting the Data Speak:</b> Racial Disparities in Unemployment and the Existence of Racial Discrimination	617
<b>22.1 Proximate Versus Fundamental Causes of Prosperity</b>	<b>583</b>	Equilibrium in a Competitive Labor Market	618
Geography	584	<b>23.3 Why Is There Unemployment?</b>	<b>619</b>
Culture	585	Voluntary Unemployment	619
Institutions	585	Job Search and Frictional Unemployment	620
A Natural Experiment of History	586	<b>23.4 Wage Rigidity and Structural Unemployment</b>	<b>620</b>
<b>22.2 Institutions and Economic Development</b>	<b>588</b>	Minimum Wage Laws	621
Inclusive and Extractive Economic Institutions	589	<b>Choice &amp; Consequence:</b> Luddites and Robots	622
How Economic Institutions Affect Economic Outcomes	589	Labor Unions and Collective Bargaining	623
<b>Letting the Data Speak:</b> Democracy and Growth	590	Efficiency Wages	623
<b>Letting the Data Speak:</b> Divergence and Convergence in Eastern Europe	592	<b>Choice &amp; Consequence:</b> Minimum Wage Laws and Employment	624
The Logic of Extractive Economic Institutions	595	Downward Wage Rigidity	625
Inclusive Economic Institutions and the Industrial Revolution	595	<b>23.5 Cyclical Unemployment and the Natural Rate of Unemployment</b>	<b>627</b>
<b>Letting the Data Speak:</b> Blocking the Railways	596	<b>Evidence-Based Economics:</b> How did unemployment and wages respond to the COVID-19 pandemic in the United States?	628
<b>Evidence-Based Economics:</b> Are tropical and semitropical areas condemned to poverty by their geographies?	597	<i>Summary</i>	630
<b>22.3 Is Foreign Aid the Solution to World Poverty?</b>	<b>602</b>	<i>Key Terms</i>	631
<b>Choice &amp; Consequence:</b> Foreign Aid and Corruption	603	<i>Questions</i>	631
<i>Summary</i>	604	<i>Evidence-Based Economics Problems</i>	631
<i>Key Terms</i>	604	<i>Problems</i>	632
<i>Questions</i>	604		
<i>Evidence-Based Economics Problems</i>	605	<b>Chapter 24: Credit Markets</b>	<b>636</b>
<i>Problems</i>	605	<b>24.1 What Is the Credit Market?</b>	<b>637</b>
<b>PART VII EQUILIBRIUM IN THE MACROECONOMY</b>	<b>608</b>	Borrowers and the Demand for Loans	637
<b>Chapter 23: Employment and Unemployment</b>	<b>608</b>	Real and Nominal Interest Rates	638
<b>23.1 Measuring Employment and Unemployment</b>	<b>609</b>	The Credit Demand Curve	639
Classifying Potential Workers	609	Saving Decisions	641
		The Credit Supply Curve	641
		<b>Choice &amp; Consequence:</b> Why Do People Save?	643
		Equilibrium in the Credit Market	644
		Credit Markets and the Efficient Allocation of Resources	644
		<b>24.2 Banks and Financial Intermediation: Putting Supply and Demand Together</b>	<b>645</b>
		<b>Letting the Data Speak:</b> Financing Start-ups	647
		Assets and Liabilities on the Balance Sheet of a Bank	647

<b>24.3 What Banks Do</b>	<b>649</b>	The Relationship Between the Federal Funds Rate and the Long-Term Real Interest Rate	682
Identifying Profitable Lending Opportunities	649	<b>Letting the Data Speak:</b> Two Models of Inflation Expectations	683
Maturity Transformation	650	Summary	686
Management of Risk	650	Key Terms	687
Bank Runs	652	Questions	687
Bank Regulation and Bank Solvency	652	Evidence-Based Economics Problems	688
<b>Evidence-based Economics:</b> How often do banks fail?	653	Problems	688
<b>Choice &amp; Consequence:</b> Too Big to Fail	655		
<b>Choice &amp; Consequence:</b> Asset Price Fluctuations and Bank Failures	656		
Summary	657		
Key Terms	657		
Questions	658		
Evidence-Based Economics Problems	658		
Problems	659		
<b>Chapter 25: The Monetary System</b>	<b>662</b>	<b>PART VIII SHORT-RUN FLUCTUATIONS AND MACROECONOMIC POLICY</b>	<b>690</b>
<b>25.1 Money</b>	<b>663</b>	<b>Chapter 26: Short-Run Fluctuations</b>	<b>690</b>
The Functions of Money	663	<b>26.1 Economic Fluctuations and Business Cycles</b>	<b>691</b>
Types of Money	664	Patterns of Economic Fluctuations	693
The Money Supply	664	The Great Depression	695
<b>Choice &amp; Consequence:</b> Non-Convertible Currencies in U.S. History	665	<b>26.2 Macroeconomic Equilibrium and Economic Fluctuations</b>	<b>697</b>
<b>25.2 Money, Prices, and GDP</b>	<b>666</b>	Labor Demand and Fluctuations	697
Nominal GDP, Real GDP, and Inflation	666	Sources of Fluctuations	699
The Quantity Theory of Money	666	<b>Letting the Data Speak:</b> Unemployment and the Growth Rate of Real GDP: Okun's Law	700
<b>25.3 Inflation</b>	<b>667</b>	Multipliers and Economic Fluctuations	704
What Causes Inflation?	667	Equilibrium in the Medium Run: Partial Recovery and Full Recovery	705
The Consequences of Inflation	668	<b>26.3 Modeling Expansions</b>	<b>709</b>
The Social Costs of Inflation	669	<b>Evidence-Based Economics:</b> What caused the recession of 2007–2009?	710
The Social Benefits of Inflation	670	<b>Evidence-Based Economics:</b> What caused the recession of 2020?	714
<b>Evidence-Based Economics:</b> What caused the German hyperinflation of 1922–1923?	671	Summary	717
<b>25.4 The Federal Reserve</b>	<b>672</b>	Key Terms	718
The Central Bank and the Objectives of Monetary Policy	672	Questions	719
What Does the Central Bank Do?	673	Evidence-Based Economics Problems	719
<b>25.5 Bank Reserves and the Plumbing of the Monetary System</b>	<b>674</b>	Problems	719
Bank Reserves and Liquidity	675		
The Demand Side of the Federal Funds Market	676	<b>Chapter 27: Countercyclical Macroeconomic Policy</b>	<b>722</b>
The Supply Side of the Federal Funds Market and Equilibrium in the Federal Funds Market	677	<b>27.1 The Role of Countercyclical Policies in Economic Fluctuations</b>	<b>723</b>
Two Ways That the Fed Controls the Federal Funds Rate	678	<b>27.2 Countercyclical Monetary Policy</b>	<b>724</b>
<b>Choice &amp; Consequence:</b> Obtaining Reserves Outside the Federal Funds Market	681	Controlling the Federal Funds Rate	725
The Fed's Influence on the Money Supply and the Inflation Rate	681	Other Tools of the Fed	728
		Expectations, Inflation, and Monetary Policy	729
		Zero Lower Bound	729

<b>Letting the Data Speak:</b> Managing Expectations in Monetary Policy	730	<b>28.3 International Trade, Technology Transfer, and Economic Growth</b>	<b>765</b>
Contractionary Monetary Policy: Reducing Inflation	732	<b>Letting the Data Speak:</b> From IBM to Lenovo	767
Policy Trade-Offs	734	<b>Evidence-Based Economics:</b> Are companies like Nike harming workers in Vietnam?	767
<b>Choice &amp; Consequence:</b> Policy Mistakes	734	Summary	770
<b>27.3 Countercyclical Fiscal Policy</b>	<b>735</b>	Key Terms	771
Fiscal Policy over the Business Cycle: Automatic and Discretionary Components	736	Questions	771
Analysis of Expenditure-Based Fiscal Policy	738	Evidence-Based Economics Problems	771
Analysis of Taxation-Based Fiscal Policy	740	Problems	772
<b>Letting the Data Speak:</b> The Response of Consumption to Tax Cuts	742	<b>Chapter 29: Open Economy Macroeconomics</b>	<b>774</b>
Fiscal Policies That Directly Target the Labor Market	742	<b>29.1 Exchange Rates</b>	<b>775</b>
Policy Waste and Policy Lags	742	Nominal Exchange Rates	775
<b>Letting the Data Speak:</b> Hybrid Policies That Involve Cooperation Between Fiscal and Monetary Policymakers	743	Flexible, Managed, and Fixed Exchange Rates	776
<b>Evidence-Based Economics:</b> How much does government expenditure stimulate GDP?	745	<b>29.2 The Foreign Exchange Market</b>	<b>778</b>
Summary	746	How Do Governments Intervene in the Foreign Exchange Market?	780
Key Terms	747	Defending an Overvalued Exchange Rate	781
Questions	747	<b>Choice &amp; Consequence:</b> Fixed Exchange Rates and Corruption	783
Evidence-Based Economics Problems	747	<b>Evidence-Based Economics:</b> How did George Soros make \$1 billion?	784
Problems	748	<b>29.3 The Real Exchange Rate and Exports</b>	<b>785</b>
<b>PART IX MACROECONOMICS IN A GLOBAL ECONOMY</b>	<b>750</b>	From the Nominal to the Real Exchange Rate	786
<b>Chapter 28: Macroeconomics and International Trade</b>	<b>750</b>	Co-Movement Between the Nominal and the Real Exchange Rates	787
<b>28.1 Why and How We Trade</b>	<b>751</b>	The Real Exchange Rate and Net Exports	788
Absolute Advantage and Comparative Advantage	751	<b>Letting the Data Speak:</b> Why Did the Chinese Authorities Keep the Yuan Undervalued?	789
Comparative Advantage and International Trade	754	<b>29.4 GDP in the Open Economy</b>	<b>790</b>
Efficiency and Winners and Losers from Trade	755	Revisiting Black Wednesday	790
How We Trade	757	Interest Rates, Exchange Rates, and Net Exports	791
<b>Letting the Data Speak:</b> Living in an Interconnected World	758	<b>Letting the Data Speak:</b> The Costs of Fixed Exchange Rates	793
<b>Choice &amp; Consequence:</b> Trade Policy and Politics	759	Summary	794
Trade Barriers: Tariffs	759	Key Terms	794
<b>28.2 The Current Account and the Financial Account</b>	<b>760</b>	Questions	794
Trade Surpluses and Trade Deficits	760	Evidence-Based Economics Problems	795
International Financial Flows	760	Problems	795
The Workings of the Current Account and the Financial Account	762	Endnotes	799
		Glossary	807
		Credits	820
		Index	823