## Detailed contents

### Guided tour
- xvi

### Student and lecturer resources
- xxii

### Preface
- xxvi

### Publisher's acknowledgements
- xxx

#### Part A  INTRODUCTION

<table>
<thead>
<tr>
<th>1 Economic issues</th>
<th>2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1 The economic problem</td>
<td>2</td>
</tr>
<tr>
<td>The problem of scarcity</td>
<td>3</td>
</tr>
<tr>
<td>Demand and supply</td>
<td>3</td>
</tr>
<tr>
<td>1.2 Dividing up the subject</td>
<td>4</td>
</tr>
<tr>
<td>Macroeconomics</td>
<td>4</td>
</tr>
<tr>
<td>Microeconomics</td>
<td>5</td>
</tr>
<tr>
<td>1.3 Modelling economic relationships</td>
<td>10</td>
</tr>
<tr>
<td>The production possibility curve</td>
<td>10</td>
</tr>
<tr>
<td>The circular flow of goods and incomes</td>
<td>12</td>
</tr>
<tr>
<td>Techniques of analysis</td>
<td>13</td>
</tr>
<tr>
<td>1.4 Economic systems</td>
<td>14</td>
</tr>
<tr>
<td>The command economy</td>
<td>14</td>
</tr>
<tr>
<td>The free-market economy</td>
<td>15</td>
</tr>
<tr>
<td>The mixed market economy</td>
<td>19</td>
</tr>
</tbody>
</table>

**Chapter 1 Boxes**

<table>
<thead>
<tr>
<th>1.1 Macroeconomic issues: A historical perspective</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.2 The opportunity costs of studying economics: What are you sacrificing?</td>
<td>8</td>
</tr>
<tr>
<td>1.3 The rise and fall of planning in the former Soviet Union: When everything didn’t go according to plan</td>
<td>16</td>
</tr>
<tr>
<td>1.4 Affording the mixed economy: The sovereign debt crisis of the early 2010s</td>
<td>20</td>
</tr>
</tbody>
</table>

#### Part B  MICROECONOMICS

<table>
<thead>
<tr>
<th>2 Markets, demand and supply</th>
<th>26</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1 Demand</td>
<td>27</td>
</tr>
<tr>
<td>The relationship between demand and price</td>
<td>27</td>
</tr>
<tr>
<td>The demand curve</td>
<td>27</td>
</tr>
<tr>
<td>Other determinants of demand</td>
<td>28</td>
</tr>
<tr>
<td>Movements along and shifts in the demand curve</td>
<td>28</td>
</tr>
<tr>
<td>2.2 Supply</td>
<td>31</td>
</tr>
<tr>
<td>Supply and price</td>
<td>31</td>
</tr>
<tr>
<td>The supply curve</td>
<td>31</td>
</tr>
<tr>
<td>Other determinants of supply</td>
<td>32</td>
</tr>
<tr>
<td>Movements along and shifts in the supply curve</td>
<td>32</td>
</tr>
<tr>
<td>2.3 The determination of price</td>
<td>33</td>
</tr>
<tr>
<td>Equilibrium price and output</td>
<td>33</td>
</tr>
<tr>
<td>Movement to a new equilibrium</td>
<td>35</td>
</tr>
<tr>
<td>2.4 The free-market economy</td>
<td>42</td>
</tr>
<tr>
<td>Advantages of a free-market economy</td>
<td>42</td>
</tr>
<tr>
<td>Problems with a free-market economy</td>
<td>42</td>
</tr>
<tr>
<td>2.5 Behavioural economics</td>
<td>43</td>
</tr>
<tr>
<td>What is behavioural economics?</td>
<td>43</td>
</tr>
<tr>
<td>Explaining ‘irrational’ consumer choices</td>
<td>43</td>
</tr>
</tbody>
</table>

**Chapter 2 Boxes**

<table>
<thead>
<tr>
<th>2.1 Getting satisfaction: Characteristics, utility and the demand curve</th>
<th>29</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.2 UK house prices: From raising the roof to falling through the floor</td>
<td>36</td>
</tr>
<tr>
<td>2.3 Stock market prices: Demand and supply in action</td>
<td>38</td>
</tr>
<tr>
<td>2.4 Commodity prices: Riding the commodities</td>
<td>40</td>
</tr>
<tr>
<td>2.5 Nudging people: How to change behaviour</td>
<td>44</td>
</tr>
</tbody>
</table>

### Part C  3 Markets in action

<table>
<thead>
<tr>
<th>3 Markets in action</th>
<th>47</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1 Price elasticity of demand</td>
<td>48</td>
</tr>
<tr>
<td>Measuring the price elasticity of demand</td>
<td>48</td>
</tr>
<tr>
<td>Interpreting the figure for elasticity</td>
<td>49</td>
</tr>
<tr>
<td>Determinants of price elasticity of demand</td>
<td>49</td>
</tr>
<tr>
<td>3.2 Price elasticity of demand and consumer expenditure</td>
<td>50</td>
</tr>
<tr>
<td>3.3 Price elasticity of supply (Pe)</td>
<td>54</td>
</tr>
<tr>
<td>The determinants of price elasticity of supply</td>
<td>55</td>
</tr>
<tr>
<td>3.4 Other elasticities</td>
<td>55</td>
</tr>
<tr>
<td>Income elasticity of demand</td>
<td>55</td>
</tr>
<tr>
<td>Cross-price elasticity of demand (Ce)</td>
<td>56</td>
</tr>
<tr>
<td>3.5 Markets and adjustment over time</td>
<td>57</td>
</tr>
<tr>
<td>Short-run and long-run adjustment</td>
<td>57</td>
</tr>
<tr>
<td>Price expectations and speculation</td>
<td>57</td>
</tr>
<tr>
<td>3.6 Uncertainty and risk</td>
<td>61</td>
</tr>
<tr>
<td>3.7 Markets where prices are controlled</td>
<td>63</td>
</tr>
<tr>
<td>Setting a minimum (high) price</td>
<td>63</td>
</tr>
<tr>
<td>Setting a maximum (low) price</td>
<td>65</td>
</tr>
</tbody>
</table>
7 Market failures and government policy 147
  7.1 Social efficiency 148
  7.2 Market failures: externalities and public goods 149
    Externalities 149
    Public goods 151
  7.3 Market failures: monopoly power 152
    Deadweight loss under monopoly 152
    Conclusions 154
  7.4 Other market failures 154
    Ignorance and uncertainty 154
    Protecting people's interests 154
    The principal-agent problem 155
    Immobility of factors and time lags in response 155
    Macroeconomic goals 157
    How far can economists go in advising governments? 157
  7.5 Government intervention: taxes and subsidies 157
    The use of taxes and subsidies 157
    Advantages of taxes and subsidies 158
    Disadvantages of taxes and subsidies 158
  7.6 Government intervention: laws and regulation 159
    Laws prohibiting or regulating undesirable structures or behaviour 159
    Regulatory bodies 160
  7.7 Other forms of government intervention 162
    Changes in property rights 162
    Provision of information 163
    The direct provision of goods and services 163
  7.8 More or less intervention? 164
    Drawbacks of government intervention 164
    Advantages of the free market 165
    Should there be more or less intervention in the market? 165
  7.9 The environment: a case study in market failure 166
    The environmental problem 166

8 Aggregate demand and the national economy 178
  8.1 Introduction to macroeconomics 179
    Key macroeconomic issues 179
  8.2 The circular flow of income model 182
    The inner flow, withdrawals and injections 183
    The relationship between withdrawals and injections 185
    The circular flow of income and the four macroeconomic objectives 185
    Disequilibrium and a chain reaction 185
  8.3 The components of aggregate demand 186
    Household consumption 186
    Investment 188
    Government expenditure 189
    Imports and exports 189
  8.4 The equilibrium level of national income 194
    Showing equilibrium with a Keynesian diagram 194
    The withdrawals and injections approach 195
    The income and expenditure approach 195
  8.5 The multiplier 196
    The withdrawals and injections approach 196
    The income and expenditure approach 197
    The multiplier: a numerical illustration 198
    Appendix: Measuring national income and output 198
    The product method 198
    The income method 199
    The expenditure method 199
    From GDP to national income 201
    Households' disposable income 201
    Taking account of inflation 202

Chapter 8 Boxes
  8.1 The household sector balance sheet: The balance sheet 190
  8.2 Sentiment and spending: Spending to be happy or happy to be spending? 192
xii DETAILED CONTENTS

8.3 The distinction between real and nominal values: Working out what is real 202
8.4 Trying to make sense of economic data: The apparently puzzling case of Japanese GDP 203

9 Aggregate supply and economic growth 206
9.1 The AD/AS model 207
   The aggregate demand curve 207
   The aggregate supply curve 208
   Equilibrium 208
9.2 Introducing economic growth 209
   The distinction between actual and potential growth 210
9.3 Short-term economic growth and the business cycle 212
   The business cycle in practice 213
9.4 Explanations of the business cycle 214
   Fluctuations in aggregate demand 214
   Fluctuations in aggregate supply 217
   Finance and trade 218
9.5 Long-term economic growth 218
   Growth over the decades 218
   Comparing the growth performance of different countries 219
9.6 Explanations of long-term growth 220
   The causes of economic growth 220
   Capital accumulation 220
   Technological progress 222
   Endogenous growth theory 223

Chapter 9 Boxes
9.1 Output gaps: An alternative measure of excess or deficient demand 210
9.2 The accelerator: an example: Demonstrating the instability of investment 216
9.3 Getting intensive with physical capital: How quickly does it grow? 224
9.4 Labour productivity: How effective is UK labour? 226

10 Banking, money and interest rates 230
10.1 The meaning and functions of money 231
   The functions of money 231
   What should count as money? 231
10.2 The financial system 232
   The key role of banks in the monetary system 232
   Liquidity, profitability and capital adequacy 237
   The central bank 242
   The role of the money markets 244
10.3 The supply of money 248
   The creation of credit 248
   The creation of credit: the real world 249
   What causes money supply to rise? 251
   The relationship between money supply and the rate of interest 253
10.4 The demand for money 254
   What determines the size of the demand for money? 255
10.5 Equilibrium 256
   Equilibrium in the money market 256
   The link between the money and goods markets 257

Chapter 10 Boxes
10.1 Financial intermediation: What is it that banks do? 233
10.2 The growth of banks’ balance sheets: The rise of wholesale funding 235
10.3 Residential mortgages and securitisation: What is the cause of the credit crunch? 240
10.4 Responses to the credit crunch: Cleansing the banking system 244
10.5 Credit and money supply: Who’s driving the M4? 252

11 Inflation and unemployment 261
11.1 Inflation 262
   Introduction to the causes of inflation 263
11.2 Money supply, aggregate demand and inflation 265
   The equation of exchange 265
   Money supply and aggregate demand 266
   Inflation and changes in aggregate demand 267
11.3 Unemployment 272
   The meaning of ‘unemployment’ 272
   Official measures of unemployment 273
   Unemployment and the labour market 274
   Types of disequilibrium unemployment 275
   Equilibrium unemployment (or natural unemployment) 278
11.4 The relationship between inflation and unemployment: the short run 280
   The recessionary gap 280
   The inflationary gap 280
   Policy implications 281
   The Phillips curve 281
11.5 The relationship between inflation and unemployment: introducing expectations: What happens when people come to expect inflation? 284
   The expectations-augmented Phillips curve 284
   The accelerationist theory 285
   The long-run Phillips curve and the equilibrium rate of unemployment 286
   Rational expectations 286
   Keynesian views 287
11.6 Inflation rate targeting and unemployment 287
   Long-term changes in unemployment 288
   Inflation targeting 289

Chapter 11 Boxes
11.1 Hyperinflation: When prices go crazy: is it the money supply? 268
11.2 The costs of unemployment: Is it just the unemployed who suffer? 273
11.3 The duration of unemployment: Taking a dip in the unemployment pool 276
11.4 Mind the gap: Do output gaps explain inflation? 282
12 Macroeconomic policy

12.1 Fiscal policy
- Deficits and surpluses
- The use of fiscal policy
- The effectiveness of fiscal policy
- Problems of magnitude
- The problem of timing
- Fiscal rules

12.2 Monetary policy
- The policy setting
- Control of the money supply over the medium and long term
- Short-term monetary measures
- Techniques to control the money supply
- Techniques to control interest rates
- Using monetary policy

12.3 Demand-side policy
- Attitudes towards demand management
- The case for rules and policy frameworks
- The case for discretion
- Difficulties with choice of target under a rules-based policy
- Constrained discretion in the UK
- Fiscal consolidation and the Coalition government

12.4 Supply-side policy
- Market-orientated supply-side policies
- Interventionist supply-side policies

Chapter 12 Boxes

12.1 UK and US fiscal policy during and after the financial crisis: From fiscal expansion to fiscal consolidation
12.2 The evolving fiscal frameworks in the UK and eurozone: Constraining government discretion over fiscal policy
12.3 The daily operation of monetary policy: What goes on at Threadneedle Street?
12.4 Monetary policy in the eurozone: The role of the ECB
12.5 Quantitative easing: Rethinking monetary policy in hard times

13 Globalisation and international trade

13.1 Global Interdependence
- Interdependence through trade
- Financial interdependence
- Global policy response

13.2 The advantages of trade
- Trading patterns
- Specialisation as the basis for trade
- The gains from trade based on comparative advantage

Chapter 13 Boxes

13.1 Doctor, the world has caught a cold! Global answers to global problems?
13.2 Trading places: Patterns and trends in world trade
13.3 Do we exploit foreign workers by buying cheap foreign imports?
13.4 The Doha Development Agenda: A new direction for the WTO?
13.5 'Features of the single market
13.6 The Chinese ‘economic miracle’: Riding the dragon

14 Balance of payments and exchange rates

14.1 The balance of payments account
- The current account
- The capital account
- The financial account

14.2 Exchange rates
- Determination of the rate of exchange in a free market

14.3 Exchange rates and the balance of payments
- Exchange rates and the balance of payments: no government or central bank intervention
- Exchange rates and the balance of payments: with government or central bank intervention

14.4 Fixed versus floating exchange rates
- Advantages of fixed exchange rates
- Disadvantages of fixed exchange rates
- Advantages of a free-floating exchange rate

Other reasons for gains from trade
- The terms of trade
- Arguments for restricting trade
- Arguments in favour of restricting trade
- Problems with protection
- The world trading system and the WTO
- Trading blocs
- The direct effects of a customs union: trade creation and trade diversion
- Longer-term effects of a customs union
- Preferential trading in practice
- The European Union
- From customs union to common market
- The benefits and costs of the single market
- Completing the internal market
- The effect of the new member states
- Trade and developing countries
- Trade strategies
- Approach 1: Exporting primaries – exploiting comparative advantage
- Approach 2: Import-substituting industrialisation (ISI)
- Approach 3: Exporting manufactures – the way forward?

Chapter 13 Boxes

13.1 Doctor, the world has caught a cold! Global answers to global problems?
13.2 Trading places: Patterns and trends in world trade
13.3 Do we exploit foreign workers by buying cheap foreign imports?
13.4 The Doha Development Agenda: A new direction for the WTO?
13.5 ‘Features of the single market
13.6 The Chinese ‘economic miracle’: Riding the dragon

Part D INTERNATIONAL ECONOMICS
<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>14.1</td>
<td>Dealing in foreign currencies: A daily juggling act</td>
<td>369</td>
</tr>
<tr>
<td>14.2</td>
<td>The importance of international financial movements: How a current account deficit can coincide with an appreciating exchange rate</td>
<td>372</td>
</tr>
<tr>
<td>14.3</td>
<td>The euro/dollar see-saw: Ups and downs in the currency market</td>
<td>374</td>
</tr>
<tr>
<td>14.4</td>
<td>Optimal currency areas: When it pays to pay in the same currency</td>
<td>380</td>
</tr>
<tr>
<td>372</td>
<td>Chapter 14 Boxes</td>
<td></td>
</tr>
<tr>
<td>373</td>
<td>Web appendix</td>
<td>W:1</td>
</tr>
<tr>
<td>376</td>
<td>Key ideas and glossary</td>
<td>K:1</td>
</tr>
<tr>
<td>377</td>
<td>Index</td>
<td>I:1</td>
</tr>
<tr>
<td>14.5</td>
<td>The origins of the euro</td>
<td></td>
</tr>
<tr>
<td>14.6</td>
<td>Economic and monetary union (EMU) in Europe</td>
<td></td>
</tr>
<tr>
<td>14.7</td>
<td>Debt and developing countries</td>
<td></td>
</tr>
<tr>
<td>14.1</td>
<td>The ERM</td>
<td></td>
</tr>
<tr>
<td>14.2</td>
<td>The Maastricht Treaty and the road to the single currency</td>
<td></td>
</tr>
<tr>
<td>14.3</td>
<td>Economic and monetary union (EMU) in Europe</td>
<td></td>
</tr>
<tr>
<td>14.4</td>
<td>Debt and developing countries</td>
<td></td>
</tr>
<tr>
<td>14.5</td>
<td>The origins of the euro</td>
<td></td>
</tr>
<tr>
<td>14.6</td>
<td>Economic and monetary union (EMU) in Europe</td>
<td></td>
</tr>
<tr>
<td>14.7</td>
<td>Debt and developing countries</td>
<td></td>
</tr>
<tr>
<td>372</td>
<td>Disadvantages of a free-floating exchange rate</td>
<td></td>
</tr>
<tr>
<td>373</td>
<td>Exchange rates in practice</td>
<td></td>
</tr>
<tr>
<td>376</td>
<td>The origins of the euro</td>
<td></td>
</tr>
<tr>
<td>376</td>
<td>The ERM</td>
<td></td>
</tr>
<tr>
<td>377</td>
<td>The Maastricht Treaty and the road to the single currency</td>
<td></td>
</tr>
<tr>
<td>378</td>
<td>Economic and monetary union (EMU) in Europe</td>
<td></td>
</tr>
<tr>
<td>378</td>
<td>Debt and developing countries</td>
<td></td>
</tr>
<tr>
<td>381</td>
<td>The Maastricht Treaty and the road to the single currency</td>
<td></td>
</tr>
<tr>
<td>382</td>
<td>Economic and monetary union (EMU) in Europe</td>
<td></td>
</tr>
<tr>
<td>383</td>
<td>Debt and developing countries</td>
<td></td>
</tr>
</tbody>
</table>