BRIEF CONTENTS

PART 1 Introduction
1 Thinking Like an Economist 3
2 Supply and Demand 25

PART 2 The Theory of Consumer Behavior
3 Rational Consumer Choice 55
4 Individual and Market Demand 95
5 Applications of Rational Choice and Demand Theories 139
6 The Economics of Information and Choice under Uncertainty 169
7 Departures from Standard Rational Choice Models
  (With and Without Regret) 213

PART 3 The Theory of the Firm and Market Structure
8 Production 248
9 Costs 281
10 Perfect Competition 317
11 Monopoly 355
12 A Game-Theoretic Approach to Strategic Behavior 397
13 Oligopoly and Monopolistic Competition 427

PART 4 Factor Markets
14 Labor 459
15 Capital 503

PART 5 General Equilibrium and Welfare
16 Externalities, Property Rights, and the Coase Theorem 533
17 General Equilibrium and Market Efficiency 567
18 Government 589
Index 619
PART I Introduction

Chapter 1 Thinking Like an Economist 3
The Cost-Benefit Approach to Decisions 4
  Example 1.1: Comparing Costs and Benefits 5
The Role of Economic Theory 6
Common Pitfalls in Decision Making 7
  Example 1.2: Implicit Cost 7
  Example 1.3: Costs and Benefits Are Reciprocal 8
  Example 1.4: Opportunity Cost 9
  Example 1.5: Sunk Cost Part 1 10
  Example 1.6: Sunk Cost Part 2 10
  Example 1.7: Comparing Costs and Benefits Part 1 12
  Example 1.8: Comparing Costs and Benefits Part 2 12
  Example 1.9: Marginal Cost and Benefit vs. Average Cost and Benefit 13
  Example 1.10: Applying the Cost-Benefit Principle 14
Using Marginal Benefit and Marginal Cost Graphically 15
  Example 1.11: Comparing Marginal Benefit and Cost Graphically 15
The Invisible Hand 16
  Example 1.12: Applying Marginal Benefit and Cost Graphically 17
Would Parents Want Their Daughter or Son to Marry Homo Economicus? 17
The Economic Naturalist 18
ECONOMIC NATURALIST 1.1: Why Is Airline Food So Bad? 18
ECONOMIC NATURALIST 1.2: Why Do Many Manual Transmissions Have Six Forward Speeds, Many Automatics Only Four? 19
Positive Questions and Normative Questions 20
Microeconomics and Macroeconomics 20
Summary 20 • Review Questions 21 • Problems 21 • Answers to Concept Checks 24 •

Chapter 2 Supply and Demand 25
Chapter Preview 25
Supply and Demand Curves 26
Equilibrium Quantity and Price 29
Adjustment to Equilibrium 30
Some Welfare Properties of Equilibrium 31
Free Markets and the Poor 32
  Example 2.1: Alternate Allocation Mechanisms 32
  Example 2.2: Excess Demand 35
Price Supports 36
Determinants of Supply and Demand 37
Predicting and Explaining Changes in Price and Quantity 40
ECONOMIC NATURALIST 2.1: Why Do the Prices of Some Goods, Such as Apples, Go Down during the Months of Heaviest Consumption While the Prices of Others, Such as Beachfront Cottages, Go Up? 40
  Example 2.3: Increasing Opportunity Cost 41
The Algebra of Supply and Demand 42
Summary 43 • Review Questions 43 • Problems 44 • Answers to Concept Checks 45 • Appendix 2A How Do Taxes Affect Equilibrium Prices And Quantities? 47

PART 2 The Theory of Consumer Behavior

Chapter 3 Rational Consumer Choice 55
Chapter Preview 55
The Opportunity Set or Budget Constraint 56
Budget Shifts Due to Price or Income Changes 58
  Example 3.1: Quantity Discounts 61
  Example 3.2: Budget Constraints 62
Consumer Preferences 63
The Best Feasible Bundle 69
  Example 3.3: Corner Solutions 72
  Example 3.4: Rational Choice Model in Action 73
ECONOMIC NATURALIST 3.1: Why Do People Often Give Gifts in Kind Instead of Cash? 75
Summary 76 • Review Questions 77 • Problems 77 • Answers to Concept Checks 80 • Appendix 3A The Utility Function Approach to the Consumer Budgeting Problem 83
Chapter 4 Individual and Market Demand 95
Chapter Preview 95
The Effects of Changes in Price 96
The Effects of Changes in Income 98
The Income and Substitution Effects of a Price Change 100
Example 4.1: Perfect Complements 104
Example 4.2: Perfect Substitutes 105
Consumer Responsiveness to Changes in Price 106
Example 4.3: Individual Demand Curves for Perfect Complements 108
Market Demand: Aggregating Individual Demand Curves 109
Example 4.4: Market Demand HO
Example 4.5: Market Demand with Identical Consumers III
Price Elasticity of Demand III
Elasticity and Total Expenditure 116
Example 4.6: Market Demand for Transit 118
The Dependence of Market Demand on Income 121
Example 4.7: The Engel Curve 121
ECONOMIC NATURALIST 4.1: Why Has the Nature of Outdoor Cooking Appliances Changed Dramatically in Recent Decades? 124
Application: Forecasting Economic Trends 125
Cross-Price Elasticities of Demand 126
Summary 126 • Review Questions 128 • Problems 128 • Answers to Concept Checks 131 • Appendix 4A Additional Topics in Demand Theory 133

Chapter 5 Applications of Rational Choice and Demand Theories 139
Chapter Preview 139
Using the Rational Choice Model to Answer Policy Questions 140
Consumer Surplus 144
Example 5.1: Consumer Surplus 145
ECONOMIC NATURALIST 5.1: Why Do Some Tennis Clubs Have an Annual Membership Charge in Addition to Their Hourly Court Fees? 146
ECONOMIC NATURALIST 5.2: Why Do Some Amusement Parks Charge Only a Fixed Admission Fee, with no Additional Charge Even for Rides with Long Lines? 147
Overall Welfare Comparisons 147
Example 5.2: Budget Constraints 148
Using Price Elasticity of Demand 153
The Intertemporal Choice Method 155
Example 5.3: Marginal Rate of Time Preference 160
Summary 163 • Review Questions 164 • Problems 166 • Answers to Concept Checks 166 •

Chapter 6 The Economics of Information and Choice under Uncertainty 169
Chapter Preview 169
The Economics of Information 170
The Costly-to-Fake Principle 171
ECONOMIC NATURALIST 6.1: Why Is Coyness Often an Attractive Attribute? 173
ECONOMIC NATURALIST 6.2: Why Do Residents of Small Towns Spend Less on Professional Clothes Than Their Counterparts in Big Cities? 174
The Full-Disclosure Principle 175
ECONOMIC NATURALIST 6.3: Why Do “Almost New” Used Cars Sell for So Much Less Than Brand New Ones? 177
Choice under Uncertainty 178
Example 6.1: Expected Utility 180
Example 6.2: Expected Value of Wealth 182
Example 6.3: Risk Neutral 184
Example 6.4: Expected Utility 185
Example 6.5: Expected Benefit 186
Insuring against Bad Outcomes 187
ECONOMIC NATURALIST 6.4: Why Was American Health Reform Legislation So Complicated? 191
Statistical Discrimination 193
Summary 195 • Review Questions 195 • Problems 196 • Answers to Concept Checks 199 • Appendix 6A Search Theory and the Winner’s Curse 201

Chapter 7 Departures from Standard Rational Choice Models (With and Without Regret) 213
Chapter Preview 215
An Application of the Present-Aim Standard: Altruistic Preferences 215
Example 7.1: Altruistic Preferences 217
The Strategic Role of Preferences 217
Tastes Not Only Can Differ, They Must Differ 221
ECONOMIC NATURALIST 7.1: Why Do People Vote in Presidential Elections? 222
Example 7.2: A Symmetric Problem 225
Bounded Rationality 227
Affective Forecasting Errors 231
Judgmental Heuristics and Biases 234
ECONOMIC NATURALIST 7.2: Why Does the Rookie of the Year in Baseball Often Have a Mediocre Second Season? 236
The Psychophysics of Perception 238
ECONOMIC NATURALIST 7.3: Why Do Real Estate Agents Often Show Clients Two Houses That Are Nearly Identical, Even Though One Is Cheaper and in Better Condition than the Other? 240
PART 3 The Theory of the Firm and Market Structure

Chapter 8 Production 248
Chapter Preview 249
The Input-Output Relationship, or Production Function 250
Production in the Short Run 252
ECONOMIC NATURALIST 8.1: Why Can't All the World's People Be Fed from the Amount of Grain Grown in a Single Flowerpot? 253
Total, Marginal, and Average Products 255
Example 8.1: Interior Solution 258
Example 8.2: Production Decision 260
Example 8.3: Efficient Allocation 260
Production in the Long Run 261
Returns to Scale 264
ECONOMIC NATURALIST 8.2: Why Do Builders Use Prefabricated Frames for Roofs but Not for Walls? 265
Summary 267 • Review Questions 267 • Problems 268 • Answers to Concept Checks 270 • Appendix 8A Mathematical Extensions of Production Theory 271

Chapter 9 Costs 281
Chapter Preview 281
Costs in the Short Run 282
Graphing the Total, Variable, and Fixed Cost Curves 284
Example 9.1: Graphing the Cost Functions 285
Other Short-Run Costs 286
Example 9.2: Determining Production Costs 289
Example 9.3: Graphing Cost Curves 291
Allocating Production between Two Processes 292
Example 9.4: Minimum-Cost Production 293
The Relationship Among MP, AP, MC, and AVC 294
Costs in the Long Run 295
ECONOMIC NATURALIST 9.1: Why Is Gravel Made by Hand in Nepal but by Machine in the United States? 298
ECONOMIC NATURALIST 9.3: Why Would a Bathroom Equipment Manufacturer Bake the Image of a Housefly onto the Center of Its Ceramic Urinals? 300

Chapter 10 Perfect Competition 317
Chapter Preview 317
The Goal of Profit Maximization 318
Example 10.1: Accounting Profits vs. Economic Profits 318
The Four Conditions for Perfect Competition 321
The Short-Run Condition for Profit Maximization 322
The Short-Run Competitive Industry Supply 326
Example 10.2: Industry Supply Curve 327
Example 10.3: Consumer and Producer Surplus 333
The Invisible Hand 336
The Long-Run Competitive Industry Supply Curve 339
Applying the Competitive Model 345
ECONOMIC NATURALIST 10.2: Why Did 18-Wheel Cargo Trucks Suddenly Begin Using Airfoils in the Mid-1970s? 348
Summary 349 • Review Questions 350 • Problems 350 • Answers to Concept Checks 353 •

Chapter 11 Monopoly 355
Chapter Preview 355
Defining Monopoly 356
Five Sources of Monopoly 357
The Profit-Maximizing Monopolist 361
Example 11.1: Marginal Revenue Curve 367
Example 11.2: Profit Maximization 368
A Monopolist Has No Supply Curve 372
Price Discrimination 373
Example 11.3: Profits in Two Different Markets 374
ECONOMIC NATURALIST 11.1: Why Do Some Doctors and Lawyers Offer Discounts to People with Low Incomes? 375
ECONOMIC NATURALIST 11.2: Why Do Theater Owners Offer Student Discounts on Admission Tickets but Not on Popcorn? 376

Long-Run Costs and the Structure of Industry 303
The Relationship between Long-Run and Short-Run Cost Curves 305
Summary 306 • Review Questions 307 • Problems 307 • Answers to Concept Checks 309 • Appendix 9A Mathematical Extensions of the Theory of Costs 311
Application: External Effects from Nuclear Power Plants 540
Property Rights 541
**ECONOMIC NATURALIST 16.1:** Why Does the Law Permit Airlines to Operate Flights over Private Land without Permission 541
**ECONOMIC NATURALIST 16.2:** Why Does the Law of Trespass Not Apply along Waterfront Property? 542
**ECONOMIC NATURALIST 16.3:** Why Are Property Rights Often Suspended during Storms? 543
**ECONOMIC NATURALIST 16.4:** Why Do Building Height Limits Vary from City to City? 544
Example 16.7: Tragedy of the Commons 546
Example 16.8: Compromise vs. Cost 550
**Positive Externalities** 551
**Positional Externalities** 552
**TAXING EXTERNALITIES** 555
Example 16.9: Taxing Externalities 555
Example 16.10: Regulation vs. Taxation 557
Summary 559 • Review Questions 560 • Problems 560 • Answers to Concept Checks 566 •

**Chapter 17: General Equilibrium and Market Efficiency** 567
Chapter Preview 567
A Simple Exchange Economy 568
Efficiency in Production 575
Efficiency in Product Mix 577
Gains from International Trade 580
Example 17.1: The Trade Decision 581
Taxes in General Equilibrium 582
Other Sources of Inefficiency 583
Summary 585 • Review Questions 586 • Problems 586 • Answers to Concept Checks 587 •

**Chapter 18: Government** 589
Chapter Preview 589
**Public Goods** 590
Private Provision of Public Goods 594
Example 18.1: Free-Rider Problem 595
**Public Choice** 598
Example 18.2: Cost-Benefit Analysis vs. Majority Rule 602
Example 18.3: Lobbying Wars 604
Income Distribution 604
Summary 614 • Review Questions 615 • Problems 615 • Answers to Concept Checks 617 •

Index 619