Economics Today

The Micro View

Roger LeRoy Miller

Research Professor of Economics, University of Texas-Arlington



BRIEF CONTENTS

Preface xi

PART 1	Introduction 1 The Nature of Economics 1 2 Scarcity and the World of Trade-Offs 26 3 Demand and Supply 48 4 Extensions of Demand and Supply Analysis 73 5 Public Spending and Public Choice 98 6 Funding the Public Sector 120
PART 5	Dimensions of Microeconomics 19 Demand and Supply Elasticity 402 20 Consumer Choice 423 21 Rents, Profits, and the Financial Environment of Business 450
PART 6	Market Structure, Resource Allocation, and Regulation The Firm: Cost and Output Determination 471 Perfect Competition 495 Monopoly 519 Monopolistic Competition 542 Oligopoly and Strategic Behavior 561 Regulation and Antitrust Policy in a Globalized Economy 582
PART 7	Labor Resources and the Environment 28 The Labor Market 605 29 Income, Poverty, and Health Care 631 30 Environmental Economics 652
PART 8	Global Economics 31 Comparative Advantage and the Open Economy 669 32 Exchange Rates and the Balance of Payments 691

CONTENTS

Preface xi

PART 1 Introduction

AI—DECISION MAKING THROUGH DATA

Microeconomic and Macroeconomic Applications 4

EXAMPLE

The Altered Incentives Confronting Prospective College Students 7 Getting Directions 8

BEHAVIORAL EXAMPLE

Assessing Whether Charitable Donations Reflect Caring for Others or for Oneself 7

BEHAVIORAL EXAMPLE

Why People with the Highest Hourly Opportunity Cost Allocate as Much Time to Leisure as Everyone Else 29

EXAMPLE

The Economic Explanation for Shrinking Airline Restrooms 31

AI—DECISION MAKING THROUGH DATA

City Management 33

POLICY EXAMPLE

City Bicycle Lanes Encounter the Law of Increasing Additional Cost 35

EXAMPLE

The Soaring Relative Price of Restaurant Meals 50 Assessing the Quality-Adjusted Prices

of Old and New Concert Violins 51 Technological Change Boosts Supply in the Jewelry Market 62

BEHAVIORAL EXAMPLE

Why Pay-What-You-Want Pricing Often Pays Off for Charitable Organizations 52

1 The Nature of Economics 1

The Power of Economic Analysis 2 • The Three Basic Economic Questions and Two Opposing Sets of Answers 4 • The Economic Approach: Systematic Decisions 6 • Economics as a Science 8

WHAT HAPPENS WHEN . . . people's actual reactions to incentives differ from how they claim they would respond in answers to survey questions? 9

Positive versus Normative Economics 10

ECONOMICS IN YOUR LIFE Government Involvement Enables a Private U.S. Housing Finance Company to Provide "Cheap" Loans 12

ISSUES & APPLICATIONS Why Fewer Men in Manufacturing Jobs Helps to Explain Why Fewer Women Are Married 12

Summary: What You Should Know 13 • Problems 14 • References 16

APPENDIX A Reading and Working with Graphs 17

Direct and Inverse Relationships 17 • Constructing a Graph 18 • Graphing Numbers in a Table 19 • The Slope of a Line (A Linear Curve) 21 • What You Should Know 24 • Problems 25

2 Scarcity and the World of Trade-Offs 26

Scarcity 27 • Opportunity Cost, Trade-Offs, and Choices 29 • The Economic Choices a Nation's People Face 32 • Economic Growth, Production Possibilities, and the Trade-Off between Present and Future 36

WHAT HAPPENS WHEN . . . new companies can handle the wastewater by-product from oil fracking at a lower opportunity cost than the oil-drilling firms that generate the wastewater as a by-product of unearthing the oil? 38

Comparative Advantage and Maximizing Your Future Income 38

ECONOMICS IN YOUR LIFE Extreme Specialization Leads One Person to Pursue Small-Rocket Launches 41

ISSUES & APPLICATIONS There Is No Such Thing as Free Parking 41

Summary: What You Should Know 43 • Problems 44 • References 47

3 Demand and Supply 48

Demand 49 • Shifts in Demand 54 • Supply 58 • Shifts in Supply 61

WHAT HAPPENS WHEN . . . both sellers and buyers anticipate that the price of an item will increase in the future? 63

Putting Demand and Supply Together 64

INTERNATIONAL EXAMPLE

In China, Lower-Priced Solar Energy Puts a Damper on the Demand for Coal 56

A British Vegetable Shortage Has Predictable Effects on Vegetable Prices 66

AI-DECISION MAKING THROUGH DATA

The Global Tourism Industry 58

AI-DECISION MAKING THROUGH DATA

Transaction Costs and "Price Stickiness" 75

EXAMPLE

The Effects of a Simultaneous Decrease in the Supply of and an Increase in the Demand for Vinyl Records 78

"99-Seat Theaters" in Los Angeles Adapt to a Minimum Wage Requirement 86

INTERNATIONAL EXAMPLE

Customers of eWater Prefer Price Rationing over First Come, First Served at a Zero Price 79

BEHAVIORAL EXAMPLE

Experimental Evidence Verifies Predictions about the Effects of Imposing a Price Floor in a Labor Market 87

EXAMPLE

Neighbors Are Not Hog Wild about a North Carolina Pig Farm 100

AI—DECISION MAKING THROUGH DATA

Contemplating Big Data as a Public Good 105

POLICY EXAMPLE

Government Sponsorship Keeps Light Rail Systems in Operation 106 Private Space Firms Recycle Rocket Boosters and Capsules That the Government Regards as Throwaways 113

BEHAVIORAL EXAMPLE

To Inhibit Nicotine Consumption, Should the Government Assume That All Consumers Behave the Same? 107

POLICY EXAMPLE

State Governments Confront Higher Debt Repayment Expenses 121

AI-DECISION MAKING THROUGH DATA

Preserving National Tax Bases 122

EXAMPLE

Average Federal Income Tax Rates and U.S. Income Tax Progressivity 123

ECONOMICS IN YOUR LIFE Space-Constrained Restaurants Discover That Customers Care about Quality-Adjusted Lunch Prices 67

ISSUES & APPLICATIONS Explaining a Consumption Shift from Soft Drinks to Bottled Water: Tastes versus Relative Prices 67

Summary: What You Should Know 69 • Problems 70 • References 72

Extensions of Demand and Supply Analysis 73

The Price System and Markets 74 • Changes in Demand and Supply 75 • The Rationing Function of Prices 78 • Price Ceilings 80

WHAT HAPPENS WHEN . . . the New York City government effectively raises the legal minimum price of cigarettes within the city's boundaries to almost twice the average U.S. price? 81

Price Floors and Quantity Restrictions 83

ECONOMICS IN YOUR LIFE A Mayor Favors the Minimum Wage until Confronting Its Consequences 87

ISSUES & APPLICATIONS Why Shortages of Some Pharmaceuticals Generate Higher Prices for Other Drugs 88

Summary: What You Should Know 89 • Problems 90 • References 93

APPENDIX B Consumer Surplus, Producer Surplus, and Gains from Trade within a Price

Consumer Surplus 94 • Producer Surplus 95 • Gains from Trade within a Price System 96 • Price Controls and Gains from Trade 97

Public Spending and Public Choice 98

Market Failures and Externalities 99

WHAT HAPPENS WHEN . . . governments require everyone to purchase health insurance? 102

The Other Economic Functions of Government 103 • The Political Functions of Government 106 • Public Spending and Transfer Programs 107 • Collective Decision Making: The Theory of Public Choice 111

ECONOMICS IN YOUR LIFE Fake "Service Pets" Create External Costs on Airline Flights 114

ISSUES & APPLICATIONS Residents of Wisconsin Learn That Services Provided by State Parks Are Not Public Goods 114

Summary: What You Should Know 115 • Problems 116 • References 119

Funding the Public Sector 120

Paying for the Public Sector: Systems of Taxation 121 • The Most Important Federal Taxes 123

WHAT HAPPENS WHEN . . . the government raises the tax rate on capital gains derived from sales of financial assets? 125

Tax Rates and Tax Revenues 127 • Taxation from the Point of View of Producers and Consumers 130

ECONOMICS IN YOUR LIFE The Connecticut Government Decides to Avoid Striking Out on Its Income Tax Policy 132

POLICY EXAMPLE

If You Generate Sales from Moving Items from Our State to Outer Space, Pay Up! 128

BEHAVIORAL EXAMPLE

Increases in Complex Sales Taxes Generate Predictable Dynamic Responses by Consumers 129 ISSUES & APPLICATIONS What Would It Take to Save Social Security as We Know It? 132 Summary: What You Should Know 133 • Problems 134 • References 136

PART 5 Dimensions of Microeconomics

EXAMPLE

The Price Elasticity of Demand for Freshman Enrollments at Private Colleges 404

INTERNATIONAL POLICY EXAMPLE

The Price Elasticity of Demand for Tesla Vehicles in Hong Kong 405

AI—DECISION MAKING THROUGH DATA

In the Pursuit of "Price Optimization" 410

BEHAVIORAL EXAMPLE

Getting Paid to Work Out 415

BEHAVIORAL EXAMPLE

Rational Rationing of Calories to Prevent Negative Marginal Utility from Food Consumption 427

AI—DECISION MAKING THROUGH DATA

An Aid for Attaining a Consumer Optimum 428

EXAMPLE

Why a Consumer Optimum Can Encompass a \$100 Plain White Cotton T-Shirt 431

POLICY EXAMPLE

State Governments Discover That a Change in the Interest Rate Affects Discounted Present Value 460

INTERNATIONAL POLICY EXAMPLE

A Government Bond Designed for a Generation of Smartphone Users 462

AI—DECISION MAKING THROUGH DATA

Supplementing or Replacing Human Financial Trading 463

EXAMPLE

Why Trying to Induce Companies to "Do the Right Thing" by "Punishing" Their Stocks Often Fails 464

19 Demand and Supply Elasticity 402

Price Elasticity 403

WHAT HAPPENS WHEN . . . a government requires firms to collect a per-unit tax on sales of a product for which demand is highly elastic? 407

Elasticity and Total Revenues 407 • Determinants of the Price Elasticity of Demand 410 • The Cross Price and Income Elasticities of Demand 413 • Price Elasticity of Supply 415

ECONOMICS IN YOUR LIFE Imposing a Philadelphia Soft Drinks Tax Reveals Information about the Price Elasticity of Demand 417

ISSUES & APPLICATIONS Tax-Induced Increases in Airline Ticket Prices, the Price Elasticity of Demand, and Airline Revenues 418

Summary: What You Should Know 419 • Problems 420 • References 421

20 Consumer Choice 423

Utility Theory 424

WHAT HAPPENS WHEN . . . consuming an additional unit of a good or service leaves total utility unchanged? 426

Optimizing Consumption Choices 428 • How a Price Change Affects Consumer Optimum 431 • Behavioral Economics and Consumer Choice Theory 434

ECONOMICS IN YOUR LIFE Boutique Sellers Offer \$2,000 Japanese-Made Jeans That Some Consumers Truly Are Happy to Buy 435

ISSUES & APPLICATIONS How Much "Intermittently Functioning" High-Tech Automotive Gadgetry Fits into a Consumer Optimum 436

Summary: What You Should Know 437 • Problems 438 • References 440

APPENDIX F More Advanced Consumer Choice Theory 441

On Being Indifferent 441 • The Budget Constraint and the Consumer Optimum 445 • Deriving the Demand Curve 447

Summary: What You Should Know 448 • Problems 449

21 Rents, Profits, and the Financial Environment of Business 450

Economic Rent 451 • Firms and Profits 452

WHAT HAPPENS WHEN . . . factors of production that a producer already owns could be leased to other firms at a higher price than previously? 455

Interest 458 • Corporate Financing Methods 461

ECONOMICS IN YOUR LIFE What New Microwave Towers Have to Do with Modern Financial Markets 465

ISSUES & APPLICATIONS Explaining the Growth in the Number of Widely Used "Stock Indexes" 465

Summary: What You Should Know 466 • Problems 467 • References 469

PART 6 Market Structure, Resource Allocation, and Regulation

EXAMPLE

A Railroad Company Rediscovers How to Obtain Maximum Feasible Production from Available Inputs 473

Airline Companies Hope to Reduce Their Total Costs at the Expense of Higher Total Fixed Costs 477

Long-Haul Trucking Firms Seek to Attain a Minimum Efficient Scale Encompassing "Last-Mile Deliveries" 489

AI—DECISION MAKING THROUGH DATA

Using Augmented Reality 479

INTERNATIONAL POLICY EXAMPLE

Government Policies May Ensure Economies of Scale for a Chinese Battery Manufacturer 487

22 The Firm: Cost and Output Determination 471

Short Run Versus Long Run 472 • A Firm's Production 473 • Short-Run Costs to the Firm 476

WHAT HAPPENS WHEN . . . total fixed cost increases at a firm? 481

Long-Run Cost Curves 485

ECONOMICS IN YOUR LIFE Returning to the Days of Sailing Ships with High-Tech Wind Cylinders 489

ISSUES & APPLICATIONS Retailers Employ AI and Robots in Pursuit of Economies of Scale 490

Summary: What You Should Know 491 • Problems 492 • References 494

AI—DECISION MAKING THROUGH DATA

Accessing All Relevant Information for "Dynamic Pricing" 497

INTERNATIONAL EXAMPLE

Reallocating Quarters and Deck Space Transforms Ocean Freighters into Partial Cruise Ships 509

EXAMPLE

Assessing the Long-Run Industry Supply Curve in the Growing Third-Party Food Delivery Industry 511

23 Perfect Competition 495

Characteristics of a Perfectly Competitive Market Structure 496 • Profit-Maximizing Choices of a Perfectly Competitive Firm 497 • Short-Run Supply under Perfect Competition 501

WHAT HAPPENS WHEN . . . a new regulation causes the marginal cost curve and, hence, the average total cost and variable cost curves to shift upward, thereby altering the short-run break-even and shutdown prices? 504

Price Determination under Perfect Competition 507 • The Long-Run Industry Situation: Exit and Entry 508

ECONOMICS IN YOUR LIFE For Urban Farmers, Industry Entry May Be Relatively Unimpeded but Still Entails a Key Expense 513

ISSUES & APPLICATIONS Higher Minimum Wage Rates and Long-Run Equilibrium in the Restaurant Industry 514

Summary: What You Should Know 515 • Problems 516 • References 518

POLICY EXAMPLE

Chicago's Licensing Barriers to Entry Limit Consumers' Access to Mobile Food Treats 522

AI—DECISION MAKING THROUGH DATA

Using "Dynamic Clustering Analysis" to Maximize Profits 529
Price Discrimination via "Personalized Pricing" 531

24 Monopoly 519

Defining and Explaining the Existence of Monopoly 520 • The Demand Curve a Monopolist Faces 523 • Costs and Monopoly Profit Maximization 525

WHAT HAPPENS WHEN . . . the demand curve faced by a monopolist shifts rightward and the monopolist wishes to determine how many units to produce to maximize economic profits? 528

On Making Higher Profits: Price Discrimination 531 • The Social Cost of Monopolies 532

ECONOMICS IN YOUR LIFE So, You Want to Provide Dietary Advice in Florida? Get a License! 533

ISSUES & APPLICATIONS The Unraveling of Taxicab Monopolies 534

Summary: What You Should Know 535 • Problems 536 • References 538

APPENDIX G Consumer Surplus and the Deadweight Loss Resulting from Monopoly 539 Consumer Surplus in a Perfectly Competitive Market 539 • How Society Loses from Monopoly 540

VIII CONTENTS

EXAMPLE

A New Wave of Product Differentiation Sweeps the Movie Theater Industry 544

BEHAVIORAL EXAMPLE

Why Physicians in Norway Behave Differently While Working in Second Jobs at Private Practices 545

AI—DECISION MAKING THROUGH DATA

Analysis of Billions of Prices 548

INTERNATIONAL EXAMPLE

The Four-Firm Concentration Ratio in the Global Tire Industry 565

EXAMPLE

The HHI for the U.S. Airline Industry 566

BEHAVIORAL EXAMPLE

Success in Game Theory Does Not Necessarily Require Complex Thinking 569

AI—DECISION MAKING THROUGH DATA

Developing a New Source of Industry Concentration 575

POLICY EXAMPLE

Cost-of-Service Regulation of the U.S. Health Insurance Industry Fails to Contain Either Costs or Prices 587

AI—DECISION MAKING THROUGH DATA

Applying a Human Regulatory Touch to Firms' Al Systems 589

BEHAVIORAL EXAMPLE

Regulatory Nudges Predicated on Paternalistic Lies 592

POLICY EXAMPLE

California Seeks to Reduce Homeowners' Energy Costs at the Expense of Higher House Prices 594

INTERNATIONAL POLICY EXAMPLE

Relevant Illegal Competition Complicates Merger Evaluations in Latin America 597

25 Monopolistic Competition 542

Monopolistic Competition 543 • Price and Output for the Monopolistic Competitor 546 • Brand Names and Advertising 549 • Information Products and Monopolistic Competition 551

WHAT HAPPENS WHEN . . . an author who independently sells an information product—a self-help e-book—and initially earns zero economic profits experiences a large increase in the demand for downloads of the item? 554

ECONOMICS IN YOUR LIFE Cruise Ships Turn to "Star Fleet" and Other Themes to Differentiate Their Services 555

ISSUES & APPLICATIONS U.S. Industries That Differentiate Their Products via Digital Advertising 555

Summary: What You Should Know 557 • Problems 557 • References 560

26 Oligopoly and Strategic Behavior 561

Oligopoly 562 • Measuring Industry Concentration 563 • Strategic Behavior and Game Theory 566 • The Cooperative Game: A Collusive Cartel 569

WHAT HAPPENS WHEN . . . the market demand curve shifts leftward in an industry with a cartel whose member firms have restrained production in order to charge the profit-maximizing monopoly price? 573

Network Effects and Two-Sided Markets 573

ECONOMICS IN YOUR LIFE Searching for Cosmetics Products with Network Effects 576

ISSUES & APPLICATIONS Why Platform Firms Must Balance Getting *More* Customers vis-à-vis Getting the *Right* Customers 577

Summary: What You Should Know 578 • Problems 579 • References 580

27 Regulation and Antitrust Policy in a Globalized Economy 582

Forms of Industry Regulation 583 • Regulating Natural Monopolies 585

what happens when . . . a natural monopoly subject to a regulatory requirement to utilize average cost pricing experiences a decline in the demand for its product? 587

Regulating Nonmonopolistic Industries 588 • Incentives and Costs of

Regulating Nonmonopolistic Industries 588 • Incentives and Costs of Regulation 591 • Antitrust Policy 594

ECONOMICS IN YOUR LIFE When a Regulation Requiring the Label "Added Sugars" Actually Means Nothing of the Sort 599

ISSUES & APPLICATIONS How Have FDA Regulatory Rules Dramatically Pushed Up Prices of Old Drugs That Now Are "New"? 600

Summary: What You Should Know 601 • Problems 601 • References 604

PART 7 Labor Resources and the Environment

INTERNATIONAL EXAMPLE

A Newly Derived Demand for German Coal Mines Relates to Energy but Not to Coal 610

28 The Labor Market 605

The Demand for Labor in a Perfectly Competitive Labor Market 606 • Wage Determination in a Perfectly Competitive Labor Market 611 • Labor Demand of a Monopolist and Overall Input Utilization 613 • Monopsony: A Buyer's Monopoly 618 • Labor Unions 622

EXAMPLE

Someday, You May Purchase a Largely Robot-Constructed House 617

AI-DECISION MAKING THROUGH DATA

Monopsonistic Decisions for Hiring Service Providers 620

POLICY EXAMPLE

In Twenty-Eight U.S. States, "Right to Work" Means No Mandatory Union "Dues" and Shrinking Union Memberships 624

ECONOMICS IN YOUR LIFE Why Tennis Clubs Are Replacing Human Line Judges with Robots 625

ISSUES & APPLICATIONS Video Games, U.S. Labor Supply, and Equilibrium Employment and Wages 625

WHAT HAPPENS WHEN . . . a nation's Lorenz curve becomes less bowed away from the

Determinants of Income Differences 636 • Poverty and Attempts to Eliminate It 640

ECONOMICS IN YOUR LIFE Targeting In-Kind Care in Government Health Programs 646

ISSUES & APPLICATIONS The Effective Marginal Tax Rate Faced by Beneficiaries of Anti-

Summary: What You Should Know 648 • Problems 649 • References 650

Summary: What You Should Know 627 • Problems 628 • References 630

EXAMPLE

Why a Rise in U.S. Wealth Inequality Can Be Blamed in Part on Aging "Baby Boomers" 636

BEHAVIORAL EXAMPLE

The Lasting Positive Effect on Lifetime Earnings of Childhood Access to Books and Parental Readings 638

POLICY EXAMPLE

The Unavoidable Implications of Some Basic Social Security Arithmetic 641

AI-DECISION MAKING THROUGH DATA

Reducing Repetitive Health Care Services 644

30 Environmental Economics 652

Private versus Social Costs 653

29 Income, Poverty, and Health Care 631

The Distribution of Income 632

Poverty Programs Who Wish to Work 647

45-degree line? 634

Health Care 642

WHAT HAPPENS WHEN . . . a nation's government imposes a uniform pollution tax even though the economic cost for the same quantity of pollution differs across locations? 656 Pollution 656 • Reducing Humanity's Carbon Footprint: Restraining Spillovers 658 Common Property and Wild Species 660

ECONOMICS IN YOUR LIFE Removing Individual Trees from View to Ensure Seeing the Forest 663

ISSUES & APPLICATIONS European Authorities Restrain the Supply of Emissions Allowances to Push Up Their Price 663

Summary: What You Should Know 664 • Problems 665 • References 667

INTERNATIONAL POLICY EXAMPLE

A Potentially High Marginal Cost of Plastic-Pollution Abatement in Kenya 658

Could South African Rhino Poaching Be Stopped by Legalizing Trade in Rhino Horns? 662

AI—DECISION MAKING THROUGH DATA

Managing Decisions Within the European Emissions Trading System 659

BEHAVIORAL EXAMPLE

Common Property, the "Paradox of Plenty," and Gains from Assigning Resource Property Rights 661

PART 8 **Global Economics**

AI-DECISION MAKING THROUGH DATA

Reshaping International Trade Flows 675

INTERNATIONAL EXAMPLE

Gains from Agricultural Specialization and Trade Conquer Distance 676

Comparative Advantage and the Open Economy 669

Why We Trade: Comparative Advantage and Mutual Gains from Exchange 670 • Arguments against Free Trade 678 • Ways to Restrict Foreign Trade 680

WHAT HAPPENS WHEN . . . a nation's government reduces an existing quota limit on foreign imports of a specific item? 681

International Trade Organizations 684

X CONTENTS

EXAMPLE

Shipping Containers and International Trade 677

INTERNATIONAL POLICY EXAMPLE

Identifying Who Loses Out as a Consequence of Asian Tariffs on Rice Imports 683

INTERNATIONAL EXAMPLE

The Non-U.S. Derived Demand for and Supply of U.S. Dollars 701

INTERNATIONAL POLICY EXAMPLE

African Governments with Dollar-Denominated Debts Confront Foreign Exchange Depreciations 707

AI—DECISION MAKING THROUGH DATA

Foreign Exchange Markets Involving Really Big Data 707 ECONOMICS IN YOUR LIFE A Potential Shift of Comparative Advantage in Olive Oil Production toward the United States 685

ISSUES & APPLICATIONS What Do Countries Gain from Involvement in Regional Trade Agreements? 686

Summary: What You Should Know 687 • Problems 688 • References 689

32 Exchange Rates and the Balance of Payments 691

The Balance of Payments and International Financial Flows 692

WHAT HAPPENS WHEN . . . U.S. spending on merchandise imports increases during the same year that foreign expenditures on U.S. merchandise exports decrease, other things being equal? 697

Deriving the Demand for and Supply of Foreign Exchange 697 • Determining Foreign Exchange Rates 701 • Fixed Versus Floating Exchange Rates 704

ECONOMICS IN YOUR LIFE The Hong Kong Monetary Authority Acts to Keep Its Currency's Exchange Rate Fixed 708

ISSUES & APPLICATIONS How Changing a Fixed Exchange Rate to Try to *Absorb* Shocks Eventually Can *Cause* Shocks 709

Summary: What You Should Know 710 • Problems 710 • References 712

Glossary 715 Index 727