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2nd Edition

Economics

FOR

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- Get to grips with consumer behaviour and its influence on the economy
- Spot the signs of a recession and see how economic decisions affect you

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Economics For Dummies[®], 2nd Edition

Table of Contents

[Introduction](#)

[About This Book](#)

[Conventions Used in This Book](#)

[What You're Not to Read](#)

[Foolish Assumptions](#)

[How This Book Is Organised](#)

[Part I: Economics: The Science of How People Deal with Scarcity](#)

[Part II: Macroeconomics: The Science of Economic Growth and Stability](#)

[Part III: Microeconomics: The Science of Consumer and Firm Behaviour](#)

[Part IV: The Part of Tens](#)

[Icons Used in This Book](#)

[Where to Go from Here](#)

[Part I: Economics: The Science of How People Deal with Scarcity](#)

[Chapter 1: What Does Economics Study? And Why Should You Care?](#)

[Considering a Little Economic History](#)

[Pondering just how nasty, brutish and short life used to be](#)

[Identifying the institutions that led to higher living standards](#)

[Looking towards the future](#)

[Sending Macroeconomics and Microeconomics to Separate Corners](#)

[Framing Economics as the Science of Scarcity](#)

[Zooming Out: Macroeconomics and the Big Picture](#)

[Measuring the economy](#)

[Recognising what causes recessions](#)

[Fighting recessions with monetary and fiscal policies](#)

[Getting up Close and Personal: Microeconomics](#)

[Balancing supply and demand](#)

[Considering why competition is so great](#)

[Examining problems caused by lack of competition](#)

[Reforming property rights](#)

[Dealing with other common market failures](#)

[Understanding How Economists Use Models and Graphs](#)

[Abstracting from reality is a good thing](#)

[Introducing your first model: The demand curve](#)

[Drawing your own demand curve](#)

[Chapter 2: Cake or Ice Cream? Tracking Consumer Choices](#)

[Considering a Model of Human Behaviour](#)

[Maximising Happiness Is the Objective](#)

[Using utility to measure happiness](#)

[Taking altruism and generosity into account](#)

[Realising that self-interest can promote the common good](#)

[Red Light: Examining Your Limitations](#)

[Resource constraints](#)

[Technology constraints](#)

[Time constraints](#)

[Opportunity cost: The unavoidable constraint](#)

[Making Your Final Choice](#)

[Exploring Limitations and Violations of the Economist's Choice Model](#)

[Understanding uninformed decision-making](#)

[Getting rational about irrationality](#)

[Chapter 3: Producing the Right Stuff in the Right Way to Maximise Human Happiness](#)

[Reaching the Limit: Determining What's Possible to Produce](#)

[Classifying resources used in production](#)

[Getting less of a good thing: Diminishing returns](#)

[Allocating resources: A little here, a little there](#)

[Graphing your production possibilities](#)

[Pushing the line with better technology](#)

[Determining What Should Be Produced](#)

[Weighing pros and cons of markets and government interventions](#)

[Opting for a mixed economy](#)

[Encouraging Technology and Innovation](#)

[Part II: Macroeconomics: The Science of Economic Growth and Stability](#)

[Chapter 4: Measuring the Macroeconomy: How Economists Keep Track of Everything](#)

[Using GDP to Track the Economy](#)

[Leaving some things out of GDP](#)

[Getting in the flow: Tallying up what counts in GDP](#)

[Considering flows of income and assets](#)

[Following the funds, around and around](#)

[Counting stuff when it's made, not when it's sold](#)

[The good, the bad and the ugly: All things increase GDP](#)

[Introducing the GDP Equation](#)

[C is for consumption](#)

[I is for investment in capital stock](#)

[G whizz! Government, that is](#)

[NX: Exports less imports](#)

[Understanding How International Trade Affects the Economy](#)

[Trade deficits can be good for you!](#)

[Considering assets – not just cash](#)

[Wielding a comparative advantage](#)

[Chapter 5: Inflation Frustration: Why More Money Isn't Always a Good Thing](#)

[Buying an Inflation: The Risks of Too Much Money](#)

[Balancing money supply and demand](#)

[Giving in to the inflation temptation](#)

[Tallying up the effects of inflation](#)

[Measuring Inflation: Price Indexes](#)

[Creating your very own market basket](#)

[Calculating the inflation rate](#)

[Setting up a price index](#)

[Determining the real standard of living with the price index](#)

[Identifying price index problems](#)

[Pricing the Future: Nominal and Real Interest Rates](#)

[Using the Fisher equation](#)

[Realising that predictions aren't perfect](#)

[Chapter 6: Understanding Why Recessions Happen](#)

[Examining the Business Cycle](#)

[Striving for Full-Employment Output](#)

[Returning to \$Y^*\$: The Natural Result of Price Adjustments](#)

[Responding to Economic Shocks: Short-Run and Long-Run Effects](#)

[Defining some critical terms](#)

[The Tao of P: Looking at price adjustments in the long run](#)

[A shock to the system: Adjusting to a shift in aggregate demand](#)

[Dealing with fixed prices in the short run](#)

[Putting together the long and short of it](#)

[Heading toward Recession: Getting Stuck with Sticky Prices](#)

[Cutting wages or cutting workers](#)

[Adding up the costs of wages and profits](#)

[Returning to \$Y^*\$ with and without government intervention](#)

[Achieving Equilibrium with Sticky Prices: The Keynesian Model](#)

[Adjusting inventories instead of prices](#)

[Boosting GDP in the Keynesian model](#)

[Chapter 7: Fighting Recessions with Monetary and Fiscal Policy](#)

[Stimulating Demand to End Recessions](#)

[Aiming for full-employment output](#)

[Shifting the AD curve to the right – or, putting people back to work](#)

[Generating Inflation: The Risk of Too Much Stimulation](#)

[An exercise in futility: Trying to increase output beyond \$Y^*\$](#)

[A temporary high: Tracing the movement of real wages](#)

[Failing to stimulate: What happens when a stimulus is expected](#)

[Figuring Out Fiscal Policy](#)

[Increasing government spending to help end recessions](#)

[Dealing with deficits](#)

Dissecting Monetary Policy

Identifying the benefits of fiat money

Realising that you can have too much money!

Getting to know bond . . . government bond

Seeing the link between bond prices and interest rates

Changing the money supply to change interest rates

Lowering interest rates to stimulate the economy

Understanding how rational expectations can limit monetary policy

Part III: Microeconomics: The Science of Consumer and Firm Behaviour

Chapter 8: Supply and Demand Made Easy

Making Sense of Markets

Deconstructing Demand

Getting our terms straight

Graphing the demand curve

Opportunity costs: Determining the slope of the demand curve

Defining demand elasticity

Sorting Out Supply

Graphing the supply curve

Understanding extreme supply cases

Interacting Supply and Demand to Find Market Equilibrium

Finding market equilibrium

Demonstrating the stability of the market equilibrium

Adjusting to New Market Equilibriums When Supply or Demand Changes

Reacting to an increase in demand

Reacting to a decrease in supply

Constructing Impediments to Market Equilibrium

Raising price ceilings

Propping up price floors

Chapter 9: Getting to Know Homo Economicus, the Utility-Maximising Consumer

Knowing the Name of the Game: Constrained Optimisation

Finding a Common Denominator to Measure Happiness: Utility

Getting Less from More: Diminishing Marginal Utility

Choosing among Many Options When Facing a Limited Budget

Trying to buy as much (marginal) utility as you can

Allocating money between two goods to maximise total utility

Equalising the marginal utility per pound of all goods and services

Deriving Demand Curves from Diminishing Marginal Utility

Seeing how price changes affect quantities demanded

Graphing the price and quantity changes to form a demand curve

Chapter 10: The Core of Capitalism: The Profit-Maximising Firm

Maximising Profits Is a Firm's Goal

Facing Competition

Listing the requirements for perfect competition

Acting as price takers but quantity makers

Distinguishing between accounting profits and economic profits

Analysing a Firm's Cost Structure

Focusing on costs per unit of output

Examining average variable costs

Watching average fixed costs fall

Tracking the movement of average total costs

Focusing on marginal costs

[Noticing where the MC curve crosses the AVC and ATC curves](#)

[Comparing Marginal Revenues with Marginal Costs](#)

[The magic formula: Finding where \$MR = MC\$](#)

[Visualising profits](#)

[Visualising losses](#)

[Pulling the Plug: When Producing Nothing Is Your Best Bet](#)

[The short-run shutdown condition: Variable costs exceed total revenues](#)

[The long-run shutdown condition: Total costs exceed total revenues](#)

[At the mercy of the market price](#)

[Chapter 11: Why Economists Love Free Markets and Competition](#)

[The Beauty of Competitive Free Markets: Ensuring That Benefits Exceed Costs](#)

[Examining prerequisites for properly functioning markets](#)

[Analysing the efficiency of free markets](#)

[Using total surplus to measure gains](#)

[When Free Markets Lose Their Freedom: Dealing with Deadweight Losses](#)

[Dissecting the deadweight loss from a price ceiling](#)

[Analysing the deadweight loss of a tax](#)

[Hallmarks of Perfect Competition: Zero Profits and Lowest Possible Costs](#)

[Understanding the causes and consequences of perfect competition](#)

[Peering into the process of perfect competition](#)

[Graphing how profits guide firm entry and exit](#)

[Chapter 12: Monopolies: How Badly Would You Behave If You Had No Competition?](#)

[Examining Profit-Maximising Monopolies](#)

[Zeroing in on the problems that monopolies cause](#)

[Identifying the source of the problem: Decreasing marginal revenues](#)

Choosing an output level to maximise profits

Comparing Monopolies with Competitive Firms

Looking at output and price levels

Deadweight losses: Quantifying the harm caused by monopolies

Focusing on efficiency

Considering Examples of Good Monopolies

Encouraging innovation and investment with patents

Reducing annoyingly redundant competitors

Keeping costs low with natural monopolies

Regulating Monopolies

Subsidising a monopoly to increase output

Imposing minimum output requirements

Regulating monopoly pricing

Breaking up a monopoly into several competing firms

Chapter 13: Oligopoly and Monopolistic Competition: Middle Grounds

Choosing to Compete or Collude

Realising that oligopoly firms interact strategically

Comparing the outcomes of competition and collusion

Cartel Behaviour: Trying to Imitate Monopolists

Co-ordinating a cartel is hard work

Examining OPEC to see the difficulties of collusion

Understanding the Prisoner's Dilemma Model

Fleshing out the Prisoner's Dilemma

Using omerta to resolve the Prisoner's Dilemma

Applying the Prisoner's Dilemma to Cartels

Seeing that OPEC is trapped in a Prisoner's Dilemma

[Using an enforcer to help OPEC members stick to quotas](#)

[Regulating Oligopolies](#)

[Dealing with dominant firms](#)

[Applying antitrust laws](#)

[Studying a Hybrid: Monopolistic Competition](#)

[Benefiting from product differentiation](#)

[Facing profit limits](#)

[Chapter 14: Property Rights and Wrongs](#)

[Allowing Markets to Reach Socially Optimal Outcomes](#)

[Examining Externalities: The Costs and Benefits Others Feel from Our Actions](#)

[Defining positive and negative externalities](#)

[Noting the effects of negative externalities](#)

[Realising that you want positive amounts of negative externalities](#)

[Dealing with negative externalities](#)

[Calculating the consequences of positive externalities](#)

[Taking in the Tragedy of the Commons](#)

[Having a cow: Overgrazing on a commonly owned field](#)

[Sleeping with the fishes: Extinctions caused by poor property rights](#)

[Chapter 15: Market Failure: Asymmetric Information and Public Goods](#)

[Facing Up to Asymmetric Information](#)

[Realising that asymmetric information limits trade](#)

[Souring on the lemons problem: The used car market and the credit crunch](#)

[Issuing insurance when you can't tell individuals apart](#)

[Providing Public Goods](#)

[Taxing to provide public goods](#)

[Enlisting philanthropy to provide public goods](#)

[Providing a public good by selling a related private good](#)

[Ranking new technology as a public good](#)

[Part IV: The Part of Tens](#)

[Chapter 16: Ten \(Or so\) Famous Economists](#)

[Adam Smith](#)

[David Ricardo](#)

[Karl Marx](#)

[Alfred Marshall](#)

[John Maynard Keynes](#)

[Kenneth Arrow and Gerard Debreu](#)

[Milton Friedman](#)

[Paul Samuelson](#)

[Robert Solow](#)

[Gary Becker](#)

[Robert Lucas](#)

[Chapter 17: Ten Seductive Economic Fallacies](#)

[The Lump of Labour Fallacy](#)

[The World Is Facing an Overpopulation Problem](#)

[The Fallacy of Confusing Sequence with Causation](#)

[Protectionism Is the Best Solution to Foreign Competition](#)

[The Fallacy of Composition](#)

[If It's Worth Doing, Do It 100 Per Cent](#)

[Free Markets Are Dangerously Unstable](#)

[Low Foreign Wages Mean That Rich Countries Can't Compete](#)

[Tax Rates Don't Affect Work Effort](#)

[Forgetting That Policies Have Unintended Consequences Too](#)

[Chapter 18: Ten Economic Ideas to Hold Dear](#)

[Society Is Better Off When People Pursue Their Own Interests](#)

[Free Markets Require Regulation](#)

[Economic Growth Depends on Innovation](#)

[Freedom and Democracy Make Us Richer](#)

[Education Raises Living Standards](#)

[Protecting Intellectual Property Rights Promotes Innovation](#)

[Weak Property Rights Cause Many Environmental Problems](#)

[International Trade Is a Good Thing](#)

[Free Enterprise Has a Hard Time Providing Public Goods](#)

[Preventing Inflation Is Easy\(ish\).](#)

[Appendix: Glossary](#)

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by Peter Antonioni and Sean Masaki Flynn



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About the Authors

Peter Antonioni was educated at Pembroke College, Oxford, and Birkbeck College, London, and has worked in both academic and private sectors as an economist before finally ending up as Lecturer in Management at University College London.

His research interests are diverse, and include the football transfer market, the process of enterprise in technology markets, and the techniques and practice of the arcane field of Long Range Scenario Planning.

His great passions include composing and recording electronic music, practicing the mystical martial arts of ancient China, and weeping with uncontrollable dismay at Spurs' latest setbacks. Amongst his talents are an uncanny ability to recall every plot point and line of dialogue from Battlestar Galactica, and the superpower of creating a mean penne arrabiata. He blogs some of the above at pja.typepad.com.

Sean Masaki Flynn earned his Ph.D. in Economics at the University of California, Berkeley, studying under Nobel Prize winners George Akerlof and Daniel McFadden.

He is a member of the American Economic Association, the American Finance Association, the Economic Science Association, and the Society for the Advancement of Behavioral Economics.

His research focuses on the often puzzling and seemingly irrational behavior of stock market investors, but he's also investigated topics as wide-ranging as the factors that affect customer tipping behaviour at restaurants and why you see a lot of unionised workers only in certain industries. He's also a leading expert on closed-end mutual funds.

His great passion is the Japanese martial art of aikido, which he has taught for over a decade to thousands of students both in the United States and abroad. If you like the martial arts, you might enjoy reading his book, *Shodokan Aikido: Basics Through 6th Kyu*, which gives an

insight into both the mental and physical aspects of aikido.

Finally, he's gone out of his way to post extensive supplementary material for this book at www.learn-economics.com. Check it out.

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– Peter Antonioni

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If you've had the patience to read this far, you'll also likely have an inclination to go check out www.learn-economics.com, where I've posted lots of supplementary material to accompany *Economics For Dummies*. You just can't get enough, can you?

– Sean Masaki Flynn

Dedication

To all the family, friends, and colleagues who did so much to set me on the true path, and especially to Andrew Scott, who showed an inordinate amount of faith in me, and Vinetta Archer-Dyer who tirelessly cleared up the mess I left in my wake.

– Peter Antonioni

To my dad, Thomas Ray Flynn, who always impressed upon me the importance of good economic policy both for

improving our quality of life and as our last, best hope for lifting billions out of poverty and disease.

– Sean Masaki Flynn

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We're proud of this book; please send us your comments through our Dummies online registration form located at www.dummies.com/register/.

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Introduction

Economics is all about humanity's struggle to achieve happiness in a world full of constraints. Too little time and money is available to do everything people want. And things like curing cancer are still impossible because the necessary technologies haven't yet been developed.

But people are clever. They tinker and invent, ponder and innovate. They look at what they have and what they can do with it and take steps to make sure that if they can't have everything, they at least have as much as possible.

Making trade-offs is key. Because you can't have everything, you have to make choices. For example, you have to choose whether to save or spend, whether to stay in school or get a job, and whether the government should spend more money on primary education or on cancer research.

Choice is a fundamental part of everyday life. The science that studies *how* people choose – economics – is indispensable if you really want to understand human beings both as individuals and as members of larger organisations.

Sadly, though, economics has typically been explained so badly that people dismiss it as impenetrable gobbledygook or stand falsely in awe of it – after all, if economics is hard to understand, it must be important, right?

We wrote this book so that you can quickly and easily understand economics for what it is – a serious science that studies a serious subject and has developed some

seriously effective ways of explaining human behaviour out in the (very serious) real world. Read this book to understand more about people, government, international relations, business, and even environmental issues such as global warming and endangered species. Economics touches on nearly everything, so the returns on reading this book are huge.

About This Book

Reading this book enables you to discover the most important economic theories, hypotheses, and discoveries without a zillion obscure details, outdated examples, or complicated mathematical 'proofs'. Among the topics covered are the following:

How the government fights recessions and unemployment using monetary and fiscal policy.

How and why international trade is good for us.

Why poorly designed property rights are responsible for environmental problems such as global warming, pollution, and species extinctions.

How profits guide businesses to produce the goods and services we take for granted.

Why competitive firms are almost always better for society than monopolies.

How the Bank of England controls the money supply, interest rates and inflation all at the same time.

Why government policies such as price controls and subsidies typically cause much more harm

than good.

How the simple supply and demand model can explain the prices of everything from comic books to open-heart surgeries.

We do our best to explain these things, and much more, clearly and directly. We also structure this book to put *you* in control. You can read the chapters in any order, and you can immediately jump to what you need to know without having to read a bunch of stuff that you couldn't care less about.

Economists like competition, so don't be surprised that a lot of competing views and paradigms exist among economists. Indeed, only through vigorous debate and careful review of the evidence can the profession improve its understanding of how the world works.

In this book, we try to steer clear of fads or ideas that foster a lot of disagreement. This book contains core ideas and concepts that economists agree are useful and important. (If you want to be subjected to our personal opinions and pet theories, you're going to have to buy us a drink.)

However, economists have honest disagreements about how to present even the core concepts, so we had to make some decisions about organisation and structure. For example, we present macroeconomics using a Keynesian framework even when we explain some rather non-Keynesian concepts. (You don't need to worry if you don't know who this Keynes fellow is or what makes him so *Keynesian*, because we introduce him to you later in the book.) Some people may quibble with this approach, but we think it makes for a succinct presentation.

Conventions Used in This Book

Economics is full of two things you may not find very appealing: jargon and algebra. To minimise confusion, whenever we introduce a new term, we put it in *italics* and follow it closely with an easy-to-understand definition. Also, whenever we bring algebra into the discussion, we use those handy *italics* again to let you know that we're referring to an algebraic element. For example, *I* indicates investment, so you may see a sentence like this one: You may say to yourself, 'I think that *I* is too big.'

We try to keep equations to a minimum, but sometimes they actually help to make things clearer. In such instances, we sometimes have to use several equations one after another. To avoid confusion about which equation we refer to at any given time, we give each equation a number, which we put in parentheses. For example,

$$\text{happy} = \text{beer} + \text{curry}^2 \quad (1)$$

Finally, the following conventions are used throughout the text of all *For Dummies* books to make things consistent and easy to understand:

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The whole point of a *For Dummies* book is to give you quick access to the essentials so that you don't have to wade through a bunch of stories, facts, and anecdotes. On the other hand, sometimes stories, facts, and anecdotes can be both fun and enlightening.

But even when they are fascinating, doesn't mean you should be forced to read them. Consequently, we clearly identify all the 'skippable' material. This information is the stuff that, although interesting and related to the topic at hand, isn't essential for you to know:

Text in sidebars: The sidebars are shaded boxes that share interesting stories and observations, but aren't necessary reading.

The bits on the acknowledgements page: Unless you're one of our friends who needs an ego boost, nothing's here for you.

Naturally, we'd like to believe that you're going to choose to read *everything* we've written, but don't worry: we aren't going to find out.

Foolish Assumptions

We wrote this book assuming some things about you:

You're sharp, thoughtful, and interested in how the world works.

You're a secondary school or university student trying to flesh out what you're learning in class, or you're a citizen of the world who realises that a good grounding in economics is going to help you understand everything from business and politics to social issues such as poverty and environmental degradation.

You want to know some economics, but you're also busy leading a very full life. Consequently, although you want the crucial facts, you don't want to have to read through a bunch of minutia to find them.

You're not totally intimidated by numbers, facts, and figures. Indeed, you welcome them because you like to have things proven to you rather than taking them on faith because some pinhead with a PhD says so.

You like discovering *why* as well as *what*. That is, you want to know why things happen and how they work rather than just memorising facts.

Finally, you're better-looking than average and have a good sense of style. In particular, you really love this book's stylish yellow and black cover and feel almost hypnotically compelled to buy a copy.

How This Book Is Organised

This book is divided into four parts to make the material easier to understand and access. Part I covers the big concepts that motivate how economists look at the world.