



Glossary

ability-to-pay principle the idea that taxes should be levied on a person according to how well that person can shoulder the burden

absolute advantage the ability to produce a good using fewer inputs than another producer

accounting profit total revenue minus total explicit cost

adverse selection the tendency for the mix of unobserved attributes to become undesirable from the standpoint of an uninformed party

agent a person who is performing an act for another person, called the principal

Arrow's impossibility theorem a mathematical result showing that, under certain assumed conditions, there is no scheme for aggregating individual preferences into a valid set of social preferences

average fixed cost fixed cost divided by the quantity of output

average revenue total revenue divided by the quantity sold

average tax rate total taxes paid divided by total income

average total cost total cost divided by the quantity of output

average variable cost variable cost divided by the quantity of output

behavioral economics the subfield of economics that integrates the insights of psychology

benefits principle the idea that people should pay taxes based on the benefits they receive from government services

budget constraint the limit on the consumption bundles that a consumer can afford

budget deficit an excess of government spending over government receipts

budget surplus an excess of government receipts over government spending

business cycle fluctuations in economic activity, such as employment and production

capital the equipment and structures used to produce goods and services

cartel a group of firms acting in unison

circular-flow diagram a visual model of the economy that shows how dollars flow through markets among households and firms

Coase theorem the proposition that if private parties can bargain without cost over the allocation of resources, they can solve the problem of externalities on their own

collusion an agreement among firms in a market about quantities to produce or prices to charge

common resources goods that are rival in consumption but not excludable

comparative advantage the ability to produce a good at a lower opportunity cost than another producer

compensating differential a difference in wages that arises to offset the nonmonetary characteristics of different jobs

competitive market a market with many buyers and sellers trading identical products so that each buyer and seller is a price taker

complements two goods for which an increase in the price of one leads to a decrease in the demand for the other

Condorcet paradox the failure of majority rule to produce transitive preferences for society

constant returns to scale the property whereby long-run average total cost stays the same as the quantity of output changes

consumer surplus the amount a buyer is willing to pay for a good minus the amount the buyer actually pays for it

corrective tax a tax designed to induce private decision makers to take account of the social costs that arise from a negative externality

cost the value of everything a seller must give up to produce a good

cost-benefit analysis a study that compares the costs and benefits to society of providing a public good

cross-price elasticity of demand a measure of how much the quantity demanded of one good responds to a change in the price of another good, computed as the percentage change in quantity demanded of the first good divided by the percentage change in the price of the second good

deadweight loss the fall in total surplus that results from a market distortion, such as a tax

demand curve a graph of the relationship between the price of a good and the quantity demanded

demand schedule a table that shows the relationship between the price of a good and the quantity demanded

diminishing marginal product the property whereby the marginal product of an input declines as the quantity of the input increases

discrimination the offering of different opportunities to similar individuals who differ only by race, ethnic group, sex, age, or other personal characteristics

diseconomies of scale the property whereby long-run average total cost rises as the quantity of output increases

dominant strategy a strategy that is best for a player in a game regardless of the strategies chosen by the other players

economic profit total revenue minus total cost, including both explicit and implicit costs

economics the study of how society manages its scarce resources

economies of scale the property whereby long-run average total cost falls as the quantity of output increases

efficiency the property of society getting the most it can from its scarce resources

efficiency wages above-equilibrium wages paid by firms to increase worker productivity

efficient scale the quantity of output that minimizes average total cost

elasticity a measure of the responsiveness of quantity demanded or quantity supplied to one of its determinants

equality the property of distributing economic prosperity uniformly among the members of society

equilibrium a situation in which the market price has reached the level at which quantity supplied equals quantity demanded

equilibrium price the price that balances quantity supplied and quantity demanded

equilibrium quantity the quantity supplied and the quantity demanded at the equilibrium price

excludability the property of a good whereby a person can be prevented from using it

explicit costs input costs that require an outlay of money by the firm

exports goods produced domestically and sold abroad

externality the uncompensated impact of one person's actions on the well-being of a bystander

factors of production the inputs used to produce goods and services

fixed costs costs that do not vary with the quantity of output produced

free rider a person who receives the benefit of a good but avoids paying for it

game theory the study of how people behave in strategic situations

Giffen good a good for which an increase in the price raises the quantity demanded

horizontal equity the idea that taxpayers with similar abilities to pay taxes should pay the same amount

human capital the knowledge and skills that workers acquire through education, training, and experience

implicit costs input costs that do not require an outlay of money by the firm

imports goods produced abroad and sold domestically

incentive something that induces a person to act

income effect the change in consumption that results when a price change moves the consumer to a higher or lower indifference curve

income elasticity of demand a measure of how much the quantity demanded of a good responds to a change in consumers' income, computed as the percentage change in quantity demanded divided by the percentage change in income

indifference curve a curve that shows consumption bundles that give the consumer the same level of satisfaction

inferior good a good for which, other things equal, an increase in income leads to a decrease in demand

inflation an increase in the overall level of prices in the economy

in-kind transfers transfers to the poor given in the form of goods and services rather than cash

internalizing the externality altering incentives so that people take account of the external effects of their actions

law of demand the claim that, other things equal, the quantity demanded of a good falls when the price of the good rises

law of supply the claim that, other things equal, the quantity supplied of a good rises when the price of the good rises

law of supply and demand the claim that the price of any good adjusts to bring the quantity supplied and the quantity demanded for that good into balance

liberalism the political philosophy according to which the government should choose policies deemed just, as evaluated by an impartial observer behind a "veil of ignorance"

libertarianism the political philosophy according to which the government should punish crimes and enforce voluntary agreements but not redistribute income

life cycle the regular pattern of income variation over a person's life

lump-sum tax a tax that is the same amount for every person

macroeconomics the study of economy-wide phenomena, including inflation, unemployment, and economic growth

marginal changes small incremental adjustments to a plan of action

marginal cost the increase in total cost that arises from an extra unit of production

marginal product the increase in output that arises from an additional unit of input

marginal product of labor the increase in the amount of output from an additional unit of labor

marginal rate of substitution the rate at which a consumer is willing to trade one good for another

marginal revenue the change in total revenue from an additional unit sold

marginal tax rate the extra taxes paid on an additional dollar of income

market a group of buyers and sellers of a particular good or service

market economy an economy that allocates resources through the decentralized decisions of many firms and households as they interact in markets for goods and services

market failure a situation in which a market left on its own fails to allocate resources efficiently

market power the ability of a single economic actor (or small group of actors) to have a substantial influence on market prices

maximin criterion the claim that the government should aim to maximize the well-being of the worst-off person in society

median voter theorem a mathematical result showing that if voters are choosing a point along a line and each voter wants the point closest to his most preferred point, then majority rule will pick the most preferred point of the median voter

microeconomics the study of how households and firms make decisions and how they interact in markets

monopolistic competition a market structure in which many firms sell products that are similar but not identical

monopoly a firm that is the sole seller of a product without close substitutes

moral hazard the tendency of a person who is imperfectly monitored to engage in dishonest or otherwise undesirable behavior

Nash equilibrium a situation in which economic factors interacting with one another each choose their best strategy given the strategies that all the other factors have chosen

natural monopoly a monopoly that arises because a single firm can supply a good or service to an entire market at a smaller cost than could two or more firms

negative income tax a tax system that collects revenue from high-income households and gives subsidies to low-income households

normal good a good for which, other things equal, an increase in income leads to an increase in demand

normative statements claims that attempt to prescribe how the world should be

oligopoly a market structure in which only a few sellers offer similar or identical products

opportunity cost whatever must be given up to obtain some item

perfect complements two goods with right-angle indifference curves

perfect substitutes two goods with straight-line indifference curves

permanent income a person's normal income

political economy the study of government using the analytic methods of economics

positive statements claims that attempt to describe the world as it is

poverty line an absolute level of income set by the federal government for each family size below which a family is deemed to be in poverty

poverty rate the percentage of the population whose family income falls below an absolute level called the poverty line

price ceiling a legal maximum on the price at which a good can be sold

price discrimination the business practice of selling the same good at different prices to different customers

price elasticity of demand a measure of how much the quantity demanded of a good responds to a change in the price of that good, computed as the percentage change in quantity demanded divided by the percentage change in price

price elasticity of supply a measure of how much the quantity supplied of a good responds to a change in the price of that good, computed as the percentage change in quantity supplied divided by the percentage change in price

price floor a legal minimum on the price at which a good can be sold

principal a person for whom another person, called the agent, is performing some act

prisoners' dilemma a particular "game" between two captured prisoners that illustrates why cooperation is difficult to maintain even when it is mutually beneficial

private goods goods that are both excludable and rival in consumption

producer surplus the amount a seller is paid for a good minus the seller's cost of providing it

production function the relationship between the quantity of inputs used to make a good and the quantity of output of that good

production possibilities frontier a graph that shows the combinations of output that the economy can possibly produce given the available factors of production and the available production technology

productivity the quantity of goods and services produced from each unit of labor input

profit total revenue minus total cost

progressive tax a tax for which high-income taxpayers pay a larger fraction of their income than do low-income taxpayers

property rights the ability of an individual to own and exercise control over scarce resources

proportional tax a tax for which high-income and low-income taxpayers pay the same fraction of income

public goods goods that are neither excludable nor rival in consumption

quantity demanded the amount of a good that buyers are willing and able to purchase

quantity supplied the amount of a good that sellers are willing and able to sell

rational people people who systematically and purposefully do the best they can to achieve their objectives

regressive tax a tax for which high-income taxpayers pay a smaller fraction of their income than do low-income taxpayers

rivalry in consumption the property of a good whereby one person's use diminishes other people's use

scarcity the limited nature of society's resources

screening an action taken by an uninformed party to induce an informed party to reveal information

shortage a situation in which quantity demanded is greater than quantity supplied

signaling an action taken by an informed party to reveal private information to an uninformed party

social insurance government policy aimed at protecting people against the risk of adverse events

strike the organized withdrawal of labor from a firm by a union

substitutes two goods for which an increase in the price of one leads to an increase in the demand for the other

substitution effect the change in consumption that results when a price change moves the consumer along a given indifference curve to a point with a new marginal rate of substitution

sunk cost a cost that has already been committed and cannot be recovered

supply curve a graph of the relationship between the price of a good and the quantity supplied

supply schedule a table that shows the relationship between the price of a good and the quantity supplied

surplus a situation in which quantity supplied is greater than quantity demanded

tariff a tax on goods produced abroad and sold domestically

tax incidence the manner in which the burden of a tax is shared among participants in a market

total cost the market value of the inputs a firm uses in production

total revenue (for firm) the amount a firm receives for the sale of its output

total revenue (in a market) the amount paid by buyers and received by sellers of a good, computed as the price of the good times the quantity sold

Tragedy of the Commons a parable that illustrates why common resources are used more than is desirable from the standpoint of society as a whole

transaction costs the costs that parties incur in the process of agreeing to and following through on a bargain

union a worker association that bargains with employers over wages, benefits, and working conditions

utilitarianism the political philosophy according to which the government should choose policies to maximize the total utility of everyone in society

utility a measure of happiness or satisfaction

value of the marginal product the marginal product of an input times the price of the output

variable costs costs that vary with the quantity of output produced

vertical equity the idea that taxpayers with a greater ability to pay taxes should pay larger amounts

welfare government programs that supplement the incomes of the needy

welfare economics the study of how the allocation of resources affects economic well-being

willingness to pay the maximum amount that a buyer will pay for a good

world price the price of a good that prevails in the world market for that good



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