

ESSENTIALS OF
Economics

N. Gregory Mankiw



FIFTH EDITION

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N. GREGORY MANKIW

HARVARD UNIVERSITY

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Library of Congress Control Number: 2008935335

ISBN-13: 978-0-324-59002-9

ISBN-10: 0-324-59002-4

Instructor's Edition ISBN 13: 978-0-324-59128-6

Instructor's Edition ISBN 10: 0-324-59128-4

South-Western Cengage Learning

5191 Natorp Boulevard

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*To Catherine, Nicholas, and Peter,
my other contributions to the next generation*



About the Author

N. Gregory Mankiw is professor of economics at Harvard University. As a student, he studied economics at Princeton University and MIT. As a teacher, he has taught macroeconomics, microeconomics, statistics, and principles of economics. He even spent one summer long ago as a sailing instructor on Long Beach Island.



Professor Mankiw is a prolific writer and a regular participant in academic and policy debates. His work has been published in scholarly journals, such as the *American Economic Review*, *Journal of Political Economy*, and *Quarterly Journal of Economics*, and in more popular forums, such as *The New York Times* and *The Wall Street Journal*. He is also author of the best-selling intermediate-level textbook *Macroeconomics* (Worth Publishers). In addition to his teaching, research, and writing, Professor Mankiw has been a research associate of the National Bureau of Economic Research, an adviser to the Federal Reserve Bank of Boston and the Congressional Budget Office, and a member of the ETS test development committee for the Advanced Placement exam in economics. From 2003 to 2005, he served as chairman of the President's Council of Economic Advisers.

Professor Mankiw lives in Wellesley, Massachusetts, with his wife, Deborah, three children, Catherine, Nicholas, and Peter, and their border terrier, Tobin.



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Preface: To the Student

“Economics is a study of mankind in the ordinary business of life.” So wrote Alfred Marshall, the great 19th-century economist, in his textbook, *Principles of Economics*. Although we have learned much about the economy since Marshall’s time, this definition of economics is as true today as it was in 1890, when the first edition of his text was published.

Why should you, as a student at the beginning of the 21st century, embark on the study of economics? There are three reasons.

The first reason to study economics is that it will help you understand the world in which you live. There are many questions about the economy that might spark your curiosity. Why are apartments so hard to find in New York City? Why do airlines charge less for a round-trip ticket if the traveler stays over a Saturday night? Why is Johnny Depp paid so much to star in movies? Why are living standards so meager in many African countries? Why do some countries have high rates of inflation while others have stable prices? Why are jobs easy to find in some years and hard to find in others? These are just a few of the questions that a course in economics will help you answer.

The second reason to study economics is that it will make you a more astute participant in the economy. As you go about your life, you make many economic decisions. While you are a student, you decide how many years to stay in school. Once you take a job, you decide how much of your income to spend, how much to save, and how to invest your savings. Someday you may find yourself running a small business or a large corporation, and you will decide what prices to charge for your products. The insights developed in the coming chapters will give you a new perspective on how best to make these decisions. Studying economics will not by itself make you rich, but it will give you some tools that may help in that endeavor.

The third reason to study economics is that it will give you a better understanding of both the potential and the limits of economic policy. Economic questions are always on the minds of policymakers in mayors’ offices, governors’ mansions, and the White House. What are the burdens associated with alternative forms of taxation? What are the effects of free trade with other countries? What is the best way to protect the environment? How does a government budget deficit affect the economy? As a voter, you help choose the policies that guide the allocation of society’s resources. An understanding of economics will help you carry out that responsibility. And who knows: Perhaps someday you will end up as one of those policymakers yourself.

Thus, the principles of economics can be applied in many of life’s situations. Whether the future finds you reading the newspaper, running a business, or sitting in the Oval Office, you will be glad that you studied economics.

N. Gregory Mankiw
September 2008

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