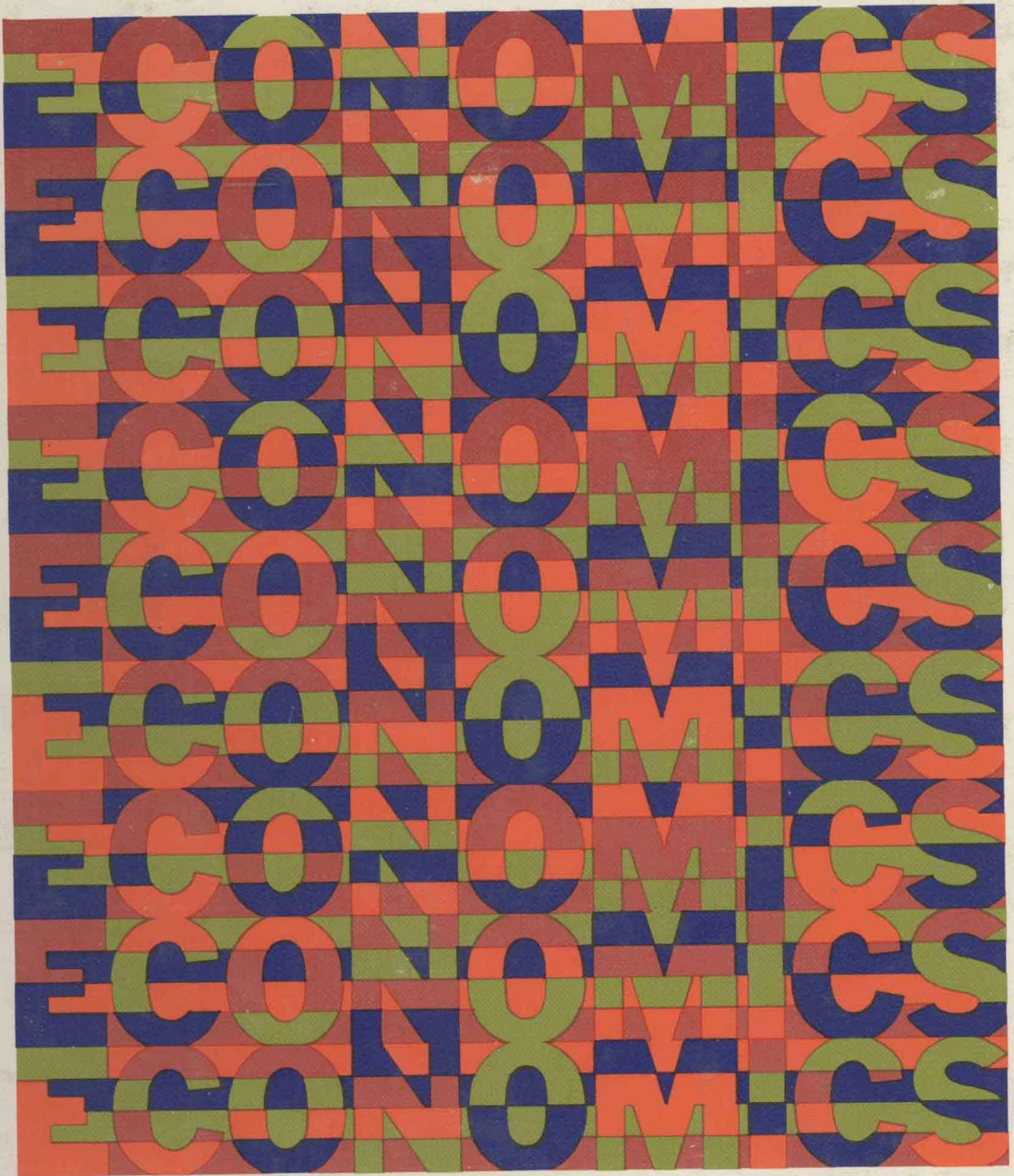


CAMPBELL R. McCONNELL



ECONOMICS

SEVENTH EDITION

SEVENTH EDITION

ECONOMICS

Principles, Problems, and Policies

CAMPBELL R. McCONNELL

Professor of Economics

University of Nebraska-Lincoln



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ECONOMICS

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PREFACE

One of the less obvious benefits of authoring a text which has met the test of the market is the opportunity for revision. Although it is a highly demanding and sometimes dreary undertaking, revision affords the chance for improvement—to delete the archaic and install the novel, to rectify errors of omission or commission, to rephrase potentially misleading statements, to introduce more relevant illustrations, to bring more pertinent data to bear, to upgrade organizational logic—in short, to build constructively upon a tested framework of ideas. Much of my time these past two years has been devoted to the preparation of this seventh edition of *Economics*. I hope and trust that those who examine this new edition will agree that I have exploited fully the opportunity afforded me.

Although the seventh edition bears only a modest resemblance to the first, the basic purpose remains the same: to introduce the beginning economics student to those principles essential to an understanding of fundamental economic problems and the policy alternatives society may utilize to contend with these problems. It is hoped that the ability to reason accurately and objectively about economic matters and the development of a lasting interest in economics will be two valuable by-products of this basic objective. Furthermore, my intention remains that of presenting the principles and problems of economics in a

straightforward, logical fashion. To this end great stress has been put upon clarity of presentation and organization.

THE SEVENTH EDITION

This edition incorporates many extensive changes. Let me briefly summarize some of the more important ones.

□ Two New Chapters

Although the total number of chapters has not changed, I can say with only slight exaggeration that two chapters are new. First, Chapter 17 is a new chapter on Monetarism. The scattered references to Monetarism found in the sixth edition have now been brought together and fleshed out to provide a systematic comparison with Keynesianism. The contrast encompasses not only analytical and policy differences, but also variance of ideological perspectives. The monetarist-Keynesian debates over fiscal policy, the efficacy of the monetary rule, and the stability of the velocity of money are all considered in some detail. Second, Chapter 18 is substantially new, although it appropriately retains some material on wage-price policies from the previous edition. The focal point is the awkward events of the 1970s. The macroeconomic record of the

past decade is presented and explained; the challenges stagflation has raised for Keynesian economics are laid out. Accelerationist and Keynesian interpretations of the 1970s are both presented as is a brief pro-and-con consideration of the rejuvenated debate over central economic planning.

□ Other Major Changes

Let us consider briefly other major changes, roughly in order of their appearance.

Chapter 4 includes a new section on various applications of the supply and demand model. In Chapter 6 the old material on social balance has been supplanted by a new discussion of the theory of public choice. Public choice theory provides a rationale for public sector failure, that is, it explains the apparent inability of government to resolve various socioeconomic problems. Also, the benefit-cost illustration has been rewritten for greater clarity. Chapters 7 and 8 on the private and public sectors have been tightened and improved; for example, the section on business accounting has been dropped and a better illustration of the mechanics of the personal income tax provided. Chapters 11 and 12 on macrotheory embody a number of changes. The classical theory has been reworked for greater clarity. The Keynesian *ex ante* inequality of saving and investment has been clarified by introducing changes in the money supply and money balances as explanatory factors. The investment demand curve has been introduced, making the discussion of investment theory more precise and tying it more closely to monetary policy. Greater emphasis is placed upon unintended inventory changes in explaining the equilibrium level of national output. Chapters 14 to 16 on money and banking have been reassessed for the purpose of tightening and sharpening the discussion throughout. For example, in Chapter 15 the discussion of the lending ability of a monopoly bank has been dropped. Chapter 16 now ties monetary policy explicitly to Keynesian theory through investment demand and

saving-investment diagrams. This chapter now ends with the synopsis of Keynesian theory and policy which was the core of Chapter 17 in the sixth edition. Chapter 20 on growth has been extensively reworked and updated; the material on the Doomsday debate has been revitalized. Chapter 21 now embodies pertinent new empirical data on the degree of inequality between the industrialized and the less developed countries, and the discussions of natural resources and sociocultural factors in growth have been redone. Material on the trade-aid role of advanced nations has been rewritten as has the section on neocolonialism. Three scenarios of possible future interrelationships between advanced and underdeveloped nations are introduced. In Chapter 23 the discussion of the determinants of the elasticity of demand has been entirely rewritten. Chapter 24 now includes a short section at its close introducing the Becker-Linder analysis which takes time into account and generalizes the theory of consumer behavior. A new section on price discrimination has been added to Chapter 28 which tends to increase its relevance. There are two major changes in Chapter 31 on wages: first, consideration is given to the recent slowdown in the rate of productivity growth; and, second, recent criticisms of human capital theory are considered. The interest rate section of Chapter 32 is entirely new, shifting from the loanable funds to the liquidity preference approach. This change allows the discussion of interest rate determination to be tied explicitly to both Keynesian theory and monetary policy. Chapter 34 embodies a modest rewrite with more discussion of regulation and related problems. Chapter 35 on agriculture has been rather substantially reworked. Distinction is now made between traditional farm policy and policies of the 1970s. The consequences and implications of market-oriented farm programs are considered. Chapter 37 on inequality has been revised thoroughly to reflect the new ideas and research of Rawls, Browning, Jencks, and Okun. The discussion of existing income maintenance programs has been rewritten and

the chapter now concludes with a synopsis of Okun's "big tradeoff" theme. In Chapter 38 the section on sex discrimination has been restructured and a simple supply and demand model of occupational discrimination added. In Chapter 40 the radical view of imperialism has been improved and extended; new material on the theory of dual labor markets has been added as a part of the explanation of poverty; and the orthodox rebuttal has been partly rewritten. The basic comparative advantage example of Chapter 41 has been recast and rephrased for greater clarity. In Chapter 42 the Trade Reform Act of 1974 and the Geneva Round of negotiations are considered and the section of East-West trade has been reworked. The historical material of Chapter 44 has been tightened and the sections on the "managed float" and special drawing rights have been rewritten. Brief comment on the "vicious circle" theory of inflation has been appended. Finally, in Chapter 45 the section on future prospects for Soviet growth has been recast and shortened.

It is to be emphasized that the above recitation of seventh edition changes is *not* comprehensive. Users of the sixth edition will be aware of many other alterations. It is safe to assert that no chapter has escaped some rewriting, revision of content, organizational improvement, or updating. The extensiveness of the revision is necessitated by the novel and troublesome changes in the economic milieu of recent years, the solicited and volunteered criticisms of users of the sixth edition, and, in no small measure, by the increased competition evident in the market for principles texts.

□ **"Last Word" Minireadings**

The built-in minireadings introduced in the sixth edition were enthusiastically received by most users. These "Last Word" selections serve several purposes: some provide meaningful real-world applications of economic concepts; others reveal "human interest" aspects of economic problems; and still others challenge the concepts and interpretations of

mainstream economics. The minireadings are purposely placed at the end of each chapter so as not to interrupt the continuity of the text material. Approximately 20 percent of the "Last Words" are new in the seventh edition.

□ **Pedagogical Improvements**

Aside from extensive content revision, the seventh edition of *Economics* embodies at least two pedagogical improvements worthy of comment. First, feedback over the years suggests that the organizational structure of *Economics* has been an important factor in explaining its market acceptance. With this in mind, I have made it a point to use subheads—particularly third- and fourth-order subheads—more liberally in the new edition to highlight the organizational framework for the student. Second, the first question found at the end of each chapter in the new edition is a list of the basic terms and concepts encountered in that particular chapter. Because any introductory course is heavily imbued with terminology, this listing should be helpful.

PRODUCT DIFFERENTIATION

In terms of content I feel this text embraces a number of departures in content and organization which distinguish it from other books in the field.

1 The principles course usually fails to provide students with a comprehensive and meaningful definition of economics. To remedy this shortcoming, one complete chapter (Chapter 2) is devoted to a careful statement and development of the economizing problem and an exploration of its implications. The foundation thereby provided should be helpful in putting the many particular subject areas of economics into proper perspective.

2 For better or worse, government is obviously an integral and increasingly important component of modern capitalism. Its economic role, therefore, should not be treated

piecemeal or as an afterthought. This text introduces the economic functions of government early and accords them systematic treatment (Chapters 6 and 9).

3 This volume puts considerable emphasis upon the crucial topic of economic growth. Chapter 19 summarizes growth theory. Chapter 20 discusses American growth, the growth controversy, and the Doomsday models. Chapter 21 draws upon the conceptual framework of Chapter 19 in treating the obstacles to growth which plague the underdeveloped countries. An important segment of Chapter 45 concerns the growth record and prospects of Soviet Russia's command economy. Beyond this it will be found that the chapters on price theory pay special attention to the implications that the various market structures have for technological progress.

4 It is understandable that the elusiveness of general equilibrium analysis eminently qualifies this topic for omission at the principles level. The result, however, is a grievous shortcoming of most introductory courses. A sincere effort is made in this book to remedy the deficiency. Specifically, an entire chapter (Chapter 5) is devoted to the notion of the price system, and another chapter (Chapter 33) explicitly outlines the nature and significance of general equilibrium analysis.

5 I have purposely given considerable attention to microeconomics in general and to the theory of the firm in particular. There are two reasons for this emphasis. In the first place, the concepts of microeconomics are difficult for most beginning students. Short expositions usually compound these difficulties by raising more questions than they answer. Secondly, I have coupled analysis of the various market structures with a discussion of the social implications of each. The impact of each market arrangement upon price and output levels, resource allocation, and the rate of technological advance is carefully assessed.

6 Part 6 provides a broad spectrum of chapters on current socioeconomic problems. As most students see it, this is where the action

is. I have sought to guide the action along logical lines through the application of appropriate analytical tools. My bias in Part 6 is in favor of inclusiveness; each instructor can effectively counter this bias by omitting those chapters he feels to be less relevant for his particular students.

ORGANIZATION AND CONTENT

In terms of organization, this book has been written with the conviction that the basic prerequisite of an understandable economics text is the logical arrangement and clear exposition of subject matter. This concern with organization is most evident in Part 1, which centers upon the step-by-step development of a comprehensive and realistic picture of American capitalism. This coherent group of introductory chapters is substituted for the traditional smattering of more or less unrelated background topics that ordinarily introduce the student to the study of economics.

Throughout this volume the exposition of each particular topic and concept is directly related to the level of difficulty which in my experience the average student is likely to encounter. It is for this reason that national income accounting, microeconomics, and to a lesser degree, employment theory are purposely accorded comprehensive and careful treatments. Simplicity in these instances is correlated with comprehensiveness, not brevity. Furthermore, my experience suggests that in the treatment of each basic topic—employment theory, money and banking, international economics, and so forth—it is highly desirable to couple analysis and policy. A three-step development of basic analytical tools is employed: (1) verbal description and illustration, (2) numerical examples, and (3) graphic presentation based upon these numerical illustrations.

The material is organized around seven basic topics: (1) an introduction to American capitalism; (2) national income, employment, and fiscal policy; (3) money and monetary

XX Preface

policy; (4) economic growth; (5) economics of the firm and resource allocation; (6) current economic problems; and (7) international economics and the Soviet economy.

Part 1 is designed to introduce the method and subject matter of economics and to develop the ideological framework and the factual characteristics of American capitalism. This group of chapters develops in an orderly fashion the overall picture of how our economy operates. After an introduction to the methodology of economics in Chapter 1, an entire chapter is devoted to defining and explaining the economizing problem. Chapters 3 to 5 develop the capitalistic ideology and the notion of the most fundamental institution of capitalism—the price system. Early emphasis upon the price system is designed to provide the necessary orientation for the detailed treatment of pricing found in Part 5 and to contribute to an understanding of the national income analysis of Part 2 and, more specifically, the topics of inflation and deflation. Chapter 6 introduces government as a basic economic component of modern capitalism; government's economic functions are systematically explained and evaluated. Upon this superstructure of a mixed public-private economy, Chapters 7 and 8 add the factual information concerning the private and public sectors of the economy, thereby making our mixed capitalism model much more realistic. However, instructors who wish to minimize institutional material may choose to omit Chapters 7 and 8.

Part 2 treats national income analysis and fiscal policy. Chapter 9 on national income accounting reflects my conviction that this difficult topic merits detailed treatment. Chapter 10 employs the national income measures in describing the last six decades of American business cycle experience. The next three chapters are devoted to neo-Keynesian employment theory, fiscal policy, and the public debt.

Part 3 emphasizes the balance sheet approach to money and banking. This approach seems most in accord with the goal of providing

the student with an analytical tool needed in reasoning through, as opposed to memorizing, the economic impact of the various basic banking transactions. Just as fiscal policy is linked directly to income theory in Part 2, monetary policy immediately follows the discussion of money and banking. Monetarism is portrayed as an alternative to Keynesianism and this is followed by a rather detailed look at the distressing macroeconomic events of the 1970s. The first half of the book is completed with Part 4 on economic growth in both the United States and the underdeveloped nations and problems related thereto.

For reasons already noted, the treatment of pricing and resource allocation in Part 5 is purposely detailed. Throughout Chapters 26 to 29 emphasis is placed upon the social implications of the various market structures. What is the significance of each market structure for price and output levels, resource allocation, and technological progress? Emphasis in the discussion of distribution—Chapters 30 to 32—is generally in accord with the relative quantitative importance of the various market shares in our economy. I have not belabored the analysis of interest, rent, and profits where, it seems to me, economic analysis is rather tentative. Chapter 33 provides a simple and, it is hoped, revealing discussion of general equilibrium and an introduction to input-output analysis.

Part 6 deals largely with domestic issues: the monopoly problem, the farm problem, the problems of the cities, the economics of inequality and poverty, labor relations and collective bargaining, the economic problems associated with war and defense, and the radical critique. Excepting Chapter 40, in each of these chapters an attempt has been made to (1) describe the historical and factual background of the problem, (2) analyze its causes and effects, (3) explore government policy, and (4) offer a thought-provoking discussion of public policy alternatives. As noted, instructors may choose to use the chapters of Part 6 selectively.

The first four chapters of Part 7 survey international trade and finance with some rigor. Finally, Chapter 45 offers a relatively comprehensive discussion of the Soviet economy, emphasizing its planning processes and its growth prospects.

End-of-chapter summaries provide a concise, pointed recapitulation of each chapter. Much thought has gone into the end-of-chapter questions. Though purposely intermixed, these questions are of three general types. Some are designed to highlight the main points of each chapter. Others are "open-end" discussion or thought questions. Wherever pertinent, numerical problems which require the student to derive and manipulate key concepts and relationships are employed. Numerical problems are stressed in those chapters dealing with national income accounting and analysis, money and banking, and price theory. Some optional "advanced analysis" questions accompany certain theory chapters. These problems usually involve the stating and manipulation of certain basic concepts in equation form. The bibliographical references at the end of each chapter are designed to provide both breadth and depth for the ambitious student. Yet care has been taken to see that these references are not beyond the grasp of the average college sophomore.

ORGANIZATIONAL ALTERNATIVES

Though economics instructors are in general agreement as to the basic content of a principles of economics course, there are considerable differences of opinion as to what particular arrangement of material is best. The structure of this book is designed to provide considerable organizational flexibility. And I am happy to report that users of prior editions have informed me that they accomplished substantial rearrangements of chapters with little sacrifice of continuity. Though I have chosen to move from macro- to microeconomics, there is no reason why the introductory material of Part 1

cannot be followed immediately by the microanalysis of Part 5. Similarly, in my judgment money and banking can best be taught after, rather than before, national income analysis. Those who disagree will encounter no problems by preceding Chapter 9 with Chapters 14, 15, and 16. Furthermore, some instructors will prefer to intersperse the microeconomics of Part 5 with the problems chapters of Part 6. This is easily accomplished. Chapter 35 on the farm problem may follow Chapter 26 on pure competition; Chapter 34 on the social control of monopoly may follow Chapters 27 to 29 on imperfect competition. Chapter 38 on labor unions and collective bargaining may either precede or follow Chapter 31 on wages, and Chapter 37 on income inequality may follow Chapters 31 and 32 on the distributive shares of national income.

Those who teach the typical two-semester course and who feel comfortable with the book's organization will find that, by putting the first four parts in the first semester and Parts 5 through 7 in the second, the material is divided both logically in terms of content and quite satisfactorily in terms of quantity and level of difficulty between the two semesters. For a course based on three quarters of work I would suggest Chapters 1 through 13 for the first quarter, 14 through 33 for the second, and 34 through 45 for the third. Finally, those interested in the one-semester course will be able to discern several possible groups of chapters that will be appropriate to such a course. Tentative outlines for three one-semester courses, emphasizing macroeconomics, microeconomics, or a survey of micro and macro theory, follow this preface on page xxiii.

SUPPLEMENTS

The seventh edition of *Economics* is accompanied by a wide range of useful supplements, making it perhaps the most complete instructional package available for the principles course.

The fifth edition of *Economic Issues: A Book of Readings* remains available as a supplement for this or any other mainstream textbook.

Professor Robert C. Bingham of Kent State University has prepared two valuable supplements. First, students have found his *Study Guide* to be an indispensable aid. The new seventh edition features an extensive glossary and a chapter-by-chapter statement of instructional objectives. Second, his *Economic Concepts* provides carefully designed programmed materials for all the key analytical areas of the principles course.

The *Personalized System of Instruction* prepared by Professor Jerry Petr of the University of Nebraska-Lincoln for the sixth edition is also available. This system of self-paced instruction offers instructors and their students an exciting new pedagogical option.

My *Instructor's Manual* includes some comments of a pedagogical character and, more important, is a reservoir of objective and essay questions. The seventh edition of the *Manual* has been substantially expanded with the addition of some 300 new multiple-choice questions. Furthermore, answers to all of the text's quantitative end-of-chapter questions are now provided for the convenience of instructors.

The *Test File* of questions which was introduced with the fourth edition is also available in enlarged form. The file contains the multiple-choice questions from the *Instructor's Manual* which can be arranged in any desired sequence and efficiently employed in constructing an examination. The *Test File* has been received enthusiastically by instructors, but somewhat less ecstatically by the publisher, who provides the *File* without charge to users of *Economics*. I am particularly pleased that other authors have accorded the *Test File* the most sincere form of flattery.

Color transparencies and black-and-white enlarged transparency masters for overhead projectors are available to those desiring these classroom aids.

DEBTS

The publication of this seventh edition extends the life of *Economics* to almost two decades. The acceptance of *Economics*, which was generous from the outset, has expanded with each edition. This surprising reception has no doubt been fostered by the many teachers and students who have been kind enough to give me the benefit of their suggestions and criticisms.

This seventh edition has benefited from comprehensive reviews by the following scholars: Professors Robin Barlow, University of Michigan; Robert J. Carbaugh, University of Wisconsin at Eau Claire; Richard M. Friedman, California State University at Northridge; Wendy L. Gramm, Texas A & M University; James B. Heisler, College of Wooster; Henry A. Knopf, Essex Community College; Randolph C. Martin, University of South Carolina; Vincent R. McDonald, Howard University; W. Arthur Parrish, Belleville Area College; and Alvin C. White, Knox College.

Professor W. H. Pope of Ryerson Polytechnical Institute, who is preparing a Canadian adaptation of *Economics*, has made many helpful suggestions. My colleagues at the University of Nebraska-Lincoln continue to be most generous in giving me both assistance and encouragement.

I am greatly indebted to the many professionals at McGraw-Hill—Stephen Dietrich, Edwin Hanson, et al.—for their expertise in the production of this book. My greatest debt is to Marjorie Singer who has been especially helpful in easing the task of revision.

Last, but not least, my daughter Lauren has again undertaken the demanding job of preparing the index.

Given this myriad of assistance, I see no compelling reason why the author should assume full responsibility for errors of omission or commission. But I bow to tradition.

Campbell R. McConnell

CONTENTS

PREFACE

xvi

THREE SUGGESTED OUTLINES FOR ONE-SEMESTER COURSES

xxiii

PART 1

AN INTRODUCTION TO AMERICAN CAPITALISM

1 THE NATURE AND METHOD OF ECONOMICS

1

THE AGE OF THE ECONOMIST Economics for citizenship Personal applications

METHODOLOGY Descriptive economics Economic theory Policy economics

TWO CHEERS FOR ECONOMISTS

PITFALLS TO STRAIGHT THINKING Terminology Bias and preconceptions

Fallacy of composition: macro and micro Prosperity and depression Cause and effect
Effect of expectations Intentions versus realizations Logical explanations
and social practice Economic quackery

LAST WORD TOWARD A CRITIQUE OF ECONOMICS

2 AN INTRODUCTION TO THE ECONOMIZING PROBLEM

23

THE FOUNDATION OF ECONOMICS Unlimited wants Scarce resources

ECONOMICS DEFINED Full employment and full production Production

possibilities table Production possibilities curve Optimum product-mix Law of
increasing costs

FURTHER IMPLICATIONS Unemployment and underemployment A growing
economy Present choices and future possibilities

ECONOMIZING: FIVE FUNDAMENTAL QUESTIONS What is to be produced

Organizing production Distributing output Level of resource use Flexibility

THE "ISMS"

LAST WORD BOMBS OR BREAD FOR INDIA?

3 PURE CAPITALISM AND THE CIRCULAR FLOW

44

CAPITALIST IDEOLOGY Private property Freedom of enterprise and choice Role
of self-interest Competition Markets and prices Limited government

OTHER CHARACTERISTICS Extensive use of capital goods Specialization

Specialization and comparative advantage Use of money

CIRCULAR FLOW OF INCOME Circular flow models Limitations

LAST WORD SPECIALIZATION AND THE ALIENATED WORKER

**4 THE MECHANICS OF INDIVIDUAL PRICES:
DEMAND AND SUPPLY**

61

DEMAND Law of demand The demand curve Individual and market demand
Determinants of demand Changes in demand Changes in quantity demanded
SUPPLY Law of supply The supply curve Determinants of supply Changes in
supply Changes in quantity supplied
SUPPLY AND DEMAND: MARKET EQUILIBRIUM Rationing function of prices
Changes in supply and demand The resource market "Other things equal"
revisited
A POWERFUL TOOL Applicability Interference: legal prices Novel uses
LAST WORD THE DEMAND FOR BASKETBALL GAMES

**5 THE FIVE FUNDAMENTAL QUESTIONS AND THE
PRICE SYSTEM**

84

FRAMEWORK OF THE PRICE SYSTEM
ECONOMIC CHOICES, SCARCITY, AND SUBSTITUTABILITY Scarcity
Substitutability Choice
OPERATION OF THE PRICE SYSTEM Determining what is to be
produced Organizing production Distributing total output Providing for
flexibility Competition and control: the "invisible hand"
AN EVALUATION OF THE PRICE SYSTEM The case for the price system The
case against the price system Relevance, realism, and the price system
LAST WORD PRODUCER, NOT CONSUMER, SOVEREIGNTY

**6 MIXED CAPITALISM AND THE ECONOMIC FUNCTIONS
OF GOVERNMENT**

105

ECONOMIC FUNCTIONS OF GOVERNMENT
LEGAL AND SOCIAL FRAMEWORK FOR THE PRICE SYSTEM
MAINTAINING COMPETITION
REDISTRIBUTION OF INCOME
REALLOCATION OF RESOURCES Spillovers or externalities Social goods and
services Allocating resources to social goods
STABILIZATION
EVALUATING GOVERNMENT'S ROLE Desirability of functions Benefit-cost
analysis
PUBLIC SECTOR FAILURE? Special interests Clear benefits, hidden costs
Nonselectivity Bureaucracy and inefficiency Imperfect institutions
THE ISSUE OF FREEDOM The conservative position The liberal stance
LAST WORD CAPITALIST DOMINATION OF THE STATE

**7 THE FACTS OF AMERICAN CAPITALISM:
THE PRIVATE SECTOR**

128

HOUSEHOLDS AS INCOME RECEIVERS Functional distribution of income
Personal distribution of income
HOUSEHOLDS AS SPENDERS Personal taxes Personal saving Personal
consumption expenditures Consumer protection
THE BUSINESS POPULATION Plants, firms, and industries Diversity and fluidity
LEGAL FORMS OF BUSINESS ENTERPRISES Sole proprietorship Partnership
Corporation To incorporate or not to incorporate
INDUSTRIAL DISTRIBUTION OF THE BUSINESS POPULATION
BIG BUSINESS IN AMERICAN CAPITALISM Extent of bigness Means and

incentives for bigness Should big business be feared?

LAST WORD BIG CORPORATIONS: THE VIEW FROM WEST VIRGINIA

8 THE FACTS OF AMERICAN CAPITALISM: THE PUBLIC SECTOR

148

PUBLIC SECTOR GROWTH Some causes Purchases versus transfers

FEDERAL FINANCE Federal expenditures Federal receipts Federal tax loopholes

STATE AND LOCAL FINANCE State expenditures and receipts Local expenditures and receipts

REVENUE SHARING

APPORTIONING THE TAX BURDEN Benefits received versus ability to pay Progressive, proportional, and regressive taxes Shifting and incidence of taxes The American tax structure

LAST WORD THE AMERICAN WAY OF TAX

PART 2

NATIONAL INCOME, EMPLOYMENT, AND FISCAL POLICY

9 NATIONAL INCOME ACCOUNTING

167

MEASURING THE ECONOMY'S PERFORMANCE

GROSS NATIONAL PRODUCT GNP is a monetary measure Adjusting GNP for price changes Inflating and deflating Double counting GNP excludes nonproductive transactions GNP and social welfare Two sides to GNP

THE EXPENDITURES APPROACH TO GNP Personal consumption expenditures (C) Government purchases of goods and services (G) Gross private domestic investment (I_g) Net exports (X_n)

THE INCOME APPROACH TO GNP Depreciation: capital consumption allowance Indirect business taxes Compensation of employees Rents Interest Proprietors' income Corporate profits

OTHER SOCIAL ACCOUNTS Net national product (NNP) National income (NI) Personal income (PI) Disposable income (DI) Relationships between major social accounts

LAST WORD NATIONAL INCOME: VOLUNTARY AND INVOLUNTARY EXPENDITURES

10 THE BUSINESS CYCLE: UNEMPLOYMENT AND INFLATION

191

THE MACROECONOMIC TRILOGY

TOTAL DEMAND, EMPLOYMENT, AND THE PRICE LEVEL Range 1: unemployment and price stability Range 2: premature inflation Range 3: full employment and pure inflation Nonreversibility

UNEMPLOYMENT Frictional unemployment Structural unemployment Cyclical unemployment Defining "full employment" Economic costs of unemployment Noneconomic costs

PRICE INSTABILITY: INFLATION AND DEFLATION Redistributive effects Output effects Creeping inflation

THE BUSINESS CYCLE Noncyclical fluctuations Cyclical impact: durables and nondurables

BUSINESS CYCLES SINCE 1920 The twenties: prosperity The thirties: the Great

Depression The forties: prosperity and inflation The war years (1940 to 1945)
 The postwar years (1946 to 1949) The fifties: economic kaleidoscope The sixties:
 a mixed bag The turbulent seventies: Four observations
 PROSPECTS FOR STABILITY
LAST WORD INFLATION IN JAPAN: UP, UP AND AWAY

11 THE BACKGROUND AND ANALYTICAL TOOLS OF EMPLOYMENT THEORY

222

THE CLASSICAL THEORY OF EMPLOYMENT Say's Law Price-wage flexibility
 Classical theory and laissez faire
 KEYNESIAN ECONOMICS The unlinking of saving and investment plans The
 discrediting of price-wage flexibility
 TOOLS OF MODERN EMPLOYMENT THEORY
 CONSUMPTION AND SAVING Income-consumption and income-saving
 relationships The consumption schedule The saving schedule Average and
 marginal propensities Nonincome determinants of consumption and saving Shifts
 and stability
 INVESTMENT Expected rate of net profits The interest rate Investment-demand
 curve Shifts in investment demand Investment and income Instability of
 investment
LAST WORD POVERTY AMIDST PLENTY

12 THE EQUILIBRIUM LEVELS OF OUTPUT, EMPLOYMENT, AND INCOME

248

AGGREGATE DEMAND-AGGREGATE SUPPLY APPROACH Tabular analysis
 Graphic analysis
 LEAKAGES-INJECTIONS APPROACH Tabular analysis Graphic analysis
 PLANNED VERSUS ACTUAL SAVING AND INVESTMENT Disequilibrium and
 inventories Achieving equilibrium
 CHANGES IN EQUILIBRIUM NNP AND THE MULTIPLIER The multiplier effect
 Paradox of thrift
 EQUILIBRIUM VERSUS FULL-EMPLOYMENT NNP Recessionary gap Inflationary
 gap Premature inflation
LAST WORD LOOKING A GIFT HORSE IN THE MOUTH

13 FISCAL POLICY AND THE PUBLIC DEBT

269

BUDGET PHILOSOPHIES Annually balanced budget Cyclically balanced
 budget Functional finance
 EMPLOYMENT ACT OF 1946 AND THE CEA
 DISCRETIONARY FISCAL POLICY Simplifying assumptions Government spending
 and equilibrium NNP Taxation and equilibrium NNP The budget impact
 Balanced-budget multiplier Fiscal policy over the cycle
 NONDISCRETIONARY FISCAL POLICY: BUILT-IN STABILIZERS Built-in stability
 Qualifications and subtleties
 TWO REFINEMENTS Financing deficits and disposing of surpluses Types of
 expenditures and taxes
 SOME COMPLICATIONS Problems of timing Political problems State and local
 finance
 THE PUBLIC DEBT Dimensions of debt Two myths Real burden of the debt
 Positive role of debt
LAST WORD THE IMPOTENCE OF FISCAL POLICY

PART 3

MONEY, MONETARY POLICY, AND ECONOMIC STABILITY

14 MONEY AND BANKING IN AMERICAN CAPITALISM 295

THE FUNCTIONS OF MONEY

MONEY IN AMERICAN CAPITALISM Money defined: M_1 Near-monies and M_2

WHAT "BACKS" THE MONEY SUPPLY? Money as debt Value of money Money and prices Managing money Recap

INSTITUTIONAL FRAMEWORK OF THE AMERICAN BANKING SYSTEM Need for centralization Structure of the Federal Reserve System Functions of the Federal Reserve System

LAST WORD A DIALOGUE ON MONEY

15 HOW BANKS CREATE MONEY 313

THE BALANCE SHEET OF A COMMERCIAL BANK

A SINGLE COMMERCIAL BANK IN A BANKING SYSTEM Formation of a commercial bank Recap Money-creating transactions of a commercial bank Profits and liquidity

THE BANKING SYSTEM: MULTIPLE-DEPOSIT EXPANSION The banking system's lending potential The monetary multiplier Some modifications

LAST WORD THE GREAT CASH MYSTERY

16 THE FEDERAL RESERVE BANKS AND MONETARY POLICY 333

OBJECTIVES OF MONETARY POLICY Cause-effect chain Monetary policy and investment

CONSOLIDATED BALANCE SHEET OF THE FEDERAL RESERVE BANKS

Assets Liabilities

MONETARY POLICY: MAJOR QUANTITATIVE CONTROLS The reserve ratio

Open-market operations The discount rate Reserve Bank credit Easy money and tight money

MONETARY POLICY: MINOR QUALITATIVE CONTROLS Selective credit controls Moral suasion

RELATIVE IMPORTANCE OF CONTROLS

MONETARY POLICY: GRAPHIC RESTATEMENT

EFFECTIVENESS OF MONETARY POLICY Shortcomings of monetary policy

Strengths of monetary policy

EMPLOYMENT THEORY AND POLICY: RECAPITULATION Consumption

Investment Government spending Fiscal and monetary policy Complexities and problems

LAST WORD PROBLEMS IN CONTROLLING THE MONEY SUPPLY

17 MONETARISM: AN ALTERNATIVE VIEW 356

PHILOSOPHICAL-IDEOLOGICAL DIFFERENCES Keynesians: political liberalism

Monetarists: laissez faire and conservatism

THE BASIC EQUATIONS Spotlight on money The fiscal policy debate The monetary rule

VELOCITY: STABLE OR UNSTABLE? Empirical evidence Velocity and the demand for money Monetarists: V is stable Keynesians: V is unstable Monetary

policy revisited A continuing debate

LAST WORD INFLATION: A MONETARY PHENOMENON?

18 UNEMPLOYMENT AND INFLATION: NEW PROBLEMS AND NEW POLICIES

371

DEMAND-PULL INFLATION

THE PHILLIPS CURVE: PREMATURE INFLATION Logic of the Phillips Curve The wage rate-productivity nexus Stabilization policy dilemma

NEW POLICY OPTIONS Market policies Wage-price policies

STAGFLATION: THE AWKWARD SEVENTIES The 1960s: stimulus and demand-pull The Nixon "game plan" Severe cost-pull shocks Why stagflation?

THE PHILLIPS CURVE REVISITED The accelerationist view Keynesian position Policy implications

LESSONS AND ISSUES Lessons of the 1970s Keynesianism and planning

LAST WORD THE SLOW ROAD TO FULL EMPLOYMENT

PART 4

ECONOMIC GROWTH: ANALYSIS AND POLICY

19 THE SIMPLE ANALYTICS OF ECONOMIC GROWTH

397

GROWTH ECONOMICS Two definitions Importance of growth Arithmetic of growth

INGREDIENTS OF GROWTH: A FIRST LOOK

GROWTH: A MORE SOPHISTICATED VIEW Law of diminishing returns The production possibilities curve and diminishing returns Diminishing returns: arithmetic example Optimum population Malthus and misery Rising productivity and growth

AGGREGATE DEMAND AND GROWTH Keeping pace with capacity

Full-employment growth model

ALLOCATIVE EFFICIENCY AND GROWTH

LAST WORD POPULATION AND THE GROWTH MYSTIQUE

20 ECONOMIC GROWTH: FACT AND CONTROVERSY

415

GROWTH RECORD OF THE UNITED STATES

SOURCES OF UNITED STATES GROWTH Natural resources Human resources

Technological advance Capital formation: investment Instability and growth

Allocative efficiency Relative importance

IS GROWTH DESIRABLE? The case against growth In defense of growth

THE DOOMSDAY MODELS

NEW HORIZONS? Fun and games with numbers? Role of technology Feedback mechanisms

LAST WORD SUMMER OF '73

21 GROWTH AND THE UNDERDEVELOPED NATIONS

435

UNDERSTANDING UNDERDEVELOPMENT Low per capita income Dimensions of inequality Implications Viewpoint of underdeveloped nations Dubious lessons of history

BREAKING THE POVERTY BARRIER Natural resources Employment of human

resources Capital accumulation Technological advance Sociocultural and institutional factors
THE VICIOUS CIRCLE: A SUMMING UP
CRUCIAL ROLE FOR GOVERNMENT
ROLE OF THE ADVANCED NATIONS Expanding trade Private capital flows
Foreign aid: public loans and grants
NEOCOLONIALISM?
THE FUTURE
LAST WORD THE THUNDER OF TINY FEET

PART 5

THE ECONOMICS OF THE FIRM AND RESOURCE ALLOCATION

22 THE MARKET STRUCTURES OF AMERICAN CAPITALISM

459

FOUR BASIC MARKET MODELS Pure competition Pure monopoly Monopolistic competition Oligopoly Imperfect competition
THE BUYER'S SIDE OF THE MARKET
OTHER COMPETITIVE DIMENSIONS Geographic factor Interindustry competition Nonprice competition Technological advance
DETERMINANTS OF MARKET STRUCTURE Legislation and government policy
Business policies and practices Technology Capitalistic institutions
LAST WORD GALBRAITHIAN ECONOMICS

23 DEMAND, SUPPLY, AND ELASTICITY: SOME APPLICATIONS

476

DEMAND, SUPPLY, AND MARKET PRICE
ELASTICITY OF DEMAND The elasticity formula Refinement: midpoints formula
The total-revenue test Characteristics Determinants of elasticity of demand Some practical applications Elasticity of supply
APPLICATIONS OF SUPPLY AND DEMAND ANALYSIS Legal prices Tax incidence Demand from the individual firm's viewpoint
LAST WORD RENT CONTROLS: A SELF-FULFILLING PROPHECY

24 FURTHER TOPICS IN THE THEORY OF CONSUMER DEMAND

500

TWO EXPLANATIONS OF THE LAW OF DEMAND Income and substitution effects Law of diminishing marginal utility
THEORY OF CONSUMER BEHAVIOR Consumer choice and budget restraint
Utility-maximizing rule An algebraic restatement
MARGINAL UTILITY AND THE DEMAND CURVE
CRITICISMS: THE TIME DIMENSION The value of time Some implications
LAST WORD DOES MONEY BUY HAPPINESS?

25 THE COSTS OF PRODUCTION

513

ECONOMIC COSTS Explicit and implicit costs Normal profits as a cost
Economic, or pure, profits Short run and long run
PRODUCTION COSTS IN THE SHORT RUN Law of diminishing returns Fixed, variable, and total costs Per unit, or average, costs Marginal cost