

ECONOMICS

CAMPBELL R. McCONNELL

NINTH EDITION

PRINCIPLES, PROBLEMS, AND POLICIES

NINTH EDITION

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ECONOMICS

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PREFACE

As is true of any activity, the authoring of a textbook entails both benefits and costs. One of the fundamental benefits is the opportunity to revise. Although a demanding and time-consuming task, 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 ninth edition of *Economics*. I hope and trust that those who examine this new edition will agree that I have made the most of the opportunity afforded me. This ninth edition of *Economics* embodies a very substantial revision and thereby contributes significantly to the metamorphosis which this book has undergone since its publication almost two and a half decades ago.

Although the ninth 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 NINTH EDITION

In addition to my own conceptions of needed changes in the content of the principles course, this revision reflects the insights and suggestions of a dozen scholars who provided detailed critiques of the eighth edition. The consequence is that each chapter has been subjected to a topic-by-topic, line-by-line evaluation. I think the reader will agree that the ninth edition of *Economics* is significantly different from its predecessor. Let me summarize the more significant revisions on a part-by-part basis.

1 Introductory The most sweeping changes in Part 1 occur in Chapter 8. It contains new material on public sector growth; a revised discussion of the personal income tax; a discussion of the Reagan administration's "new federalism"; new data on the distribution of the tax burden; treatment of the provisions of the Economic Recovery Tax Act of 1981; new material on proposals to encourage reindustrialization through the tax system; and a summary of the cases for and against a flat-rate income tax. This is not to say other chapters have been neglected. Chapter 1 has been shortened; Chapter 2 contains pertinent new applications of the production possibilities curve. Chapters 1, 3, 5, 6, and 7 feature new Last Words. All chapters have been carefully reworked for clarity and to update illustrations.

2 Macroeconomics In Chapter 9 the circular flow summary of the national income accounts has been relocated to tie it more closely with the text. The chapter

now has a comprehensive summary, rather than a mere restatement of key definitions. The section on the underground economy has been expanded and the Last Word is new. Chapter 10's discussion of the effects of inflation has been carefully reworked and the Last Word is new. Chapter 11 is a new chapter which provides students with a brief overview of macro theory and policy. This is accomplished in terms of the "new" aggregate demand–aggregate supply model which directly incorporates the price level as a key variable. A framework is thereby provided which can be used to integrate supply-side considerations with traditional Keynesian analysis in succeeding chapters. Overall the price level is a more integral part of theory and policy and supply-side considerations are accorded earlier and more systematic treatment. The student is also made aware of the turmoil within the profession as to what constitutes the most meaningful model of the macroeconomy. In Chapter 12 the price level is explicitly treated as a determinant of the consumption schedule and the inflationary and recessionary gap discussion has been reworked in Chapter 13. The supply side ramifications of fiscal policy are treated in Chapter 14 and a new Last Word on the balanced budget amendment is featured.

3 Money This group of chapters has been reworked for the Depository Institutions Deregulation and Monetary Control Act (DIDMCA) and its many ramifications. Chapter 15 has been accorded the most extensive revision and reorganization. More attention is accorded the thrift institutions, "checkable deposits," and the *M1*, *M2*, and *M3* money concepts. The chapter has also been reorganized so that the supply of money is discussed completely before money demand is introduced. The Last Word segment of this chapter provides a synopsis of the major provisions of DIDMCA and their purposes. Chapter 16 contains the new DIDMCA reserve requirements and Chapter 17 features some rewrite of the open-market operations, margin requirement, and policy dilemma sections. The new Last Word explores the pros and cons of the gold standard. Chapter 19 on stagflation has been very extensively rewritten and reorganized to fit within the aggregate demand–aggregate supply framework introduced in Chapter 11. More specifically, the discussion of supply-side economics is extended and "Reaganomics" is presented and evalu-

ated. The new Last Word attempts to explain our inability to formulate and apply antistagflation policies.

4 Growth This section is now comprised of only two chapters; the chapter on the less developed countries has been relocated in Part 7. Chapter 20's section on the productivity slowdown has been reworked and the new Last Word is concerned with the population predictions of the *Global 2000 Report*. In Chapter 21 the eighth edition's rather optimistic discussion of American growth has been toned down and greater stress is placed upon the decline in our per capita GNP ranking and our declining competitiveness in certain world markets. New material on our decaying infrastructure and labor quality problems is included. The section on the Doomsday models is tightened and updated. The new Last Word attempts to explain the remarkable growth record of Japan.

5 Microeconomics Chapter 23 now features a new tabular summary of the price elasticity discussion, several new applications, and a pedagogically improved discussion of the shifting and incidence of sales taxes. The treatment of production costs in Chapter 25 has been improved by the addition of a diagram which compares economic and accounting costs. Similarly, a new diagram and discussion more closely relates the shapes of the marginal and average variable cost curves to the marginal and average product curves. The new Last Word summarizes important new empirical work on economies of scale. In Chapter 26 the discussion on competition and efficiency has been reworked for greater clarity and to distinguish between "allocative efficiency" and "productive efficiency." In Chapter 27 on monopoly a new diagram clarifies the relationship between demand, marginal revenue, and total revenue; all three concepts are tied to price elasticity. The organization of the chapter has been improved by relocating the material on price discrimination after the section on the economic effects of monopoly. There is now a new section on concentration ratios in Chapter 29 and that chapter's case study on the automobile industry has been reworked to emphasize increased foreign competition and the industry's recent problems. The section on substitute and complementary resources has been rewritten for greater clarity in Chapter 30 and a technical note has

been added to explain the compatibility of the profit-maximizing output and input rules. Chapter 31 contains a section on wage increases and employment; some reworking of the minimum wage discussion; new findings on the size of the union-nonunion wage differential; and a tightening of the section on human capital.

6 Problems Chapter 34 on antitrust features a rewrite of the sections on workable competition and the Federal Trade Commission plus sections summarizing the Reagan administration's approach to antitrust policy and regulation. The new Last Word provides a balanced appraisal of government regulations. Chapter 35 contains new material on target pricing. The economic effects of farm price supports and price targets are compared and the allocative inefficiencies of both are stressed. The Reagan payments-in-kind program is summarized and a short concluding section addresses the world hunger debate. Chapter 36 on urban economics has been condensed and reorganized. The material on fiscal problems has been reworked for the Reagan administration's new federalism. A new Last Word shows how "congestion pricing" has been used in Singapore to help solve their urban transportation problem. Chapter 37 now contains a discussion of the controversy surrounding the accuracy of census data on income distribution plus new data and a new diagram showing the effects of taxes and transfers upon income inequality. The Last Word is new. Chapter 38 on labor unions and labor history has been condensed to make room for a rather thorough discussion of legal and illegal immigration. A simple demand-supply model presents the basic effects of immigration upon sending and receiving countries and then the model is systematically adjusted for such complications as unemployment, fiscal effects, and so on. Chapter 39 on energy has been reworked for the effects of the 1979-1980 price runup, the current world oil glut, OPEC's recent disarray, and embodies a new Last Word.

7 International Chapter 41 on world trade includes new material on the growth of United States' trade and a discussion of the pattern of that trade. Chapter 42 on protectionism features greater emphasis upon the special-interest effect, an improved presentation of the cheap-labor argument for protection, and an expla-

nation of the recent upsurge in protectionist pressures. In Chapter 44 the material on the course of the dollar in the post-float era has been rewritten. Chapter 45 puts greater emphasis on the diversity among the less developed countries and features a new extended section on the New International Economic Order. Chapter 46 includes a more precise discussion of Soviet five- and one-year plans, more on "planning by negotiation," new material on Russia's "second economy," new data on living standards, new statistics and discussion concerning the Soviet growth slowdown, and a new Last Word.

"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. Twenty-eight of the forty-six "Last Words" are new in the ninth edition.

PRODUCT DIFFERENTIATION

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

1 / The principles course frequently 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 8).

3 / This volume puts considerable emphasis upon the crucial topic of economic growth. Chapter 20 summarizes growth theory. Chapter 21 discusses American growth, the growth controversy, and the Doomsday models. Chapter 45 draws upon the conceptual framework of Chapter 20 in treating the obstacles to growth which plague the underdeveloped countries. An important segment of Chapter 46 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 this deficiency. Specifically, an entire chapter (Chapter 5) is devoted to the notion of the price system, and another chapter (Chapter 33) explicitly outlines in more sophisticated terms 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 felt to be less relevant for a particular group of 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 perhaps 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 frequently 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.

As noted in the summary of major ninth edition changes, the material is organized around seven basic topics: (1) an introduction to American capitalism; (2) macro theory and fiscal policy; (3) money and monetary policy; (4) economic growth; (5) economics of the firm and resource allocation; (6) current economic problems; and (7) international economics and the world 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 in 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-descriptive material may choose to omit Chapters 7 and 8.

Part 2 treats macro theory and fiscal policy. Chapter 9 on national income accounting reflects my conviction that this difficult topic merits detailed treatment. Some instructors may choose to truncate this discussion by omitting or deemphasizing the income approach to GNP which is less relevant to the ensuing theory chapters than is the expenditures approach. Chapter 10 treats the characteristics, causes, and consequences of cyclical fluctuations. Chapter 11 presents an overview of macro theory and policy and 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 stagflation and the various policies which have been proposed to prevent or remedy that unhappy combination of events. The first half of the book is completed with Part 4 on economic growth and the problems and controversies 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. Labor markets are accorded rather extended discussion, but I have not belabored the analysis of rent, interest, and profits. Chapter 33 provides a capstone discussion of general equilibrium, including 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 energy problem, 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. Chapter 45 deals with the problems and prospects of the less developed countries. Finally, Chapter 46 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. The first question at the end of each chapter is a list of important terms and concepts encountered in that particular chapter. Because the introductory course is heavily imbued with terminology, this listing should prove helpful. Though purposely intermixed, all other 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. Answers to all quantitative questions are found in the *Instructor's Manual*. 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 special problems by preceding Chapter 9 with Chapters 15, 16, and 17. 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 antitrust and regulation 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.

Other rearrangements to consider include the placement of Chapter 10 on the business cycle after either Chapter 13 or 14 and the shifting of Chapter 22 on market structures so that it is considered after Chapter

25. Finally, because the energy problem and its consequences are international in scope, one can see advantages in considering Chapter 39 after either Chapter 43 or 44.

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 those instructors who choose to put more emphasis upon international economics, it is suggested that Parts 1, 2, 3, and 7 be treated the first semester and Parts 4, 5, and 6 the second. For a course based on three quarters of work I would suggest Chapters 1 through 14 for the first quarter, 15 through 33 for the second, and 34 through 46 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 xxx.

SUPPLEMENTS

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

The fifth edition of my *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. It contains for each chapter an introductory statement, a checklist of behavioral objectives, an outline, a list of important terms, fill-in questions, problems and projects, objective questions, and discussion questions. An extensive glossary is found at the conclusion of the volume. The *Guide* comprises, in my opinion, a superb "portable tutor" for the principles student. Second, Professor Bingham's *Economic Concepts* provides carefully

designed programmed materials for all the key analytical areas of the principles course. *Economic Concepts* can be used as an effective supplement with any mainstream text.

My *Instructor's Manual* includes some comments of a pedagogical character and, more importantly, is a reservoir of objective and essay questions. The ninth edition of the *Manual* has been substantially expanded with the addition of some 500 new multiple-choice questions. As noted earlier, answers to all the text's quantitative end-of-chapter questions are provided for the convenience of instructors.

The ninth edition *Instructor's Manual* is keyed to a computerized test service, the EXAMINER system. All the multiple-choice and true-false questions in the *Instructor's Manual* are coded with computer numbers so that instructors desiring to prepare quizzes and examinations can do so very efficiently by using this system. Detailed information needed to implement this system can be found in the *Instructor's Manual*.

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 ninth edition extends the life of *Economics* well into its third decade. The acceptance of *Economics*, which was generous from the outset, has expanded with each edition. This kind reception has no doubt been fostered by the many teachers and students who have been good enough to give me the benefit of their suggestions and criticisms.

The ninth edition has benefited from many perceptive reviews. The contributors of these reviews, to whom I am especially grateful, are Mahmoud P. Arya, Edison Community College; Enrique Auza, Los Angeles City College; Margaret S. Bond, University of Alabama-Huntsville; William G. Forgang, University of Wisconsin-Oshkosh; Ki Hoon Kim, Central Connecticut State College; Joseph S. La Cascia, Marshall University; John G. Marcis, Virginia Commonwealth University; Ferideh Mehran, Penn State University; H. C. Milikien, American River College; Sam F. Parigi, Lamar Univer-

sity; William L. Schreiber, Citrus College; John M. Trapani, University of Texas-Arlington.

My colleagues at the University of Nebraska—Lincoln continue to generously share knowledge of their specialties with me and to provide encouragement. I am especially indebted to Professors J. R. Felton, Harish Gupta, and Jerry Petr who have been most helpful in offsetting my comparative ignorance in their areas of specialty.

Professor Dudley G. Lockett of Iowa State University provided a very helpful review of the monetary theory and policy chapters. Professor W. H. Pope of Ryerson Polytechnical Institute in his role as coauthor of the Canadian edition of *Economics* has provided both general guidance and innumerable suggestions for improvement. Similarly, Professor John Jackson of the University of Western Australia, who coauthors the Australian edition of *Economics*, has contributed useful criticisms. Professor Robert Catlett of Emporia State University critically reviewed the aforementioned EXAMINER computerized test service and made important suggestions for its improvement. My three children—Beth, Curt, and Lauren—have been active participants in this revision. They have assumed such tedious tasks as proofreading, updating statistical tables, preparing the index, and library research. I am pleased to acknowledge publicly their contributions.

Lastly, I am greatly indebted to the many professionals at McGraw-Hill—and in particular Bonnie Lieberman, Patricia Mitchell, Mel Haber, Phil Galea, and Nelson Black—for their expertise in the production and distribution of this book. Betty Binns has given the book another of her unique designs. My greatest debt is to Edwin Hanson for direct supervision of this revision.

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

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