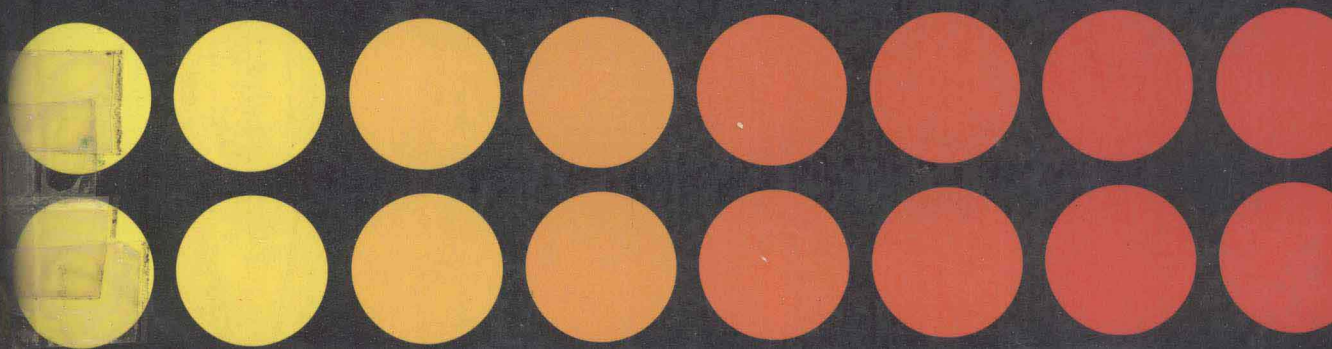


PHILIP HARDWICK · BAHADUR KHAN · JOHN LANGMEAD

# An introduction to modern economics

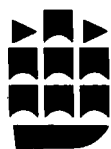


# **An introduction to modern economics**

**Philip Hardwick**

**Bahadur Khan**

**John Langmead**



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# Foreword

Yet another textbook on economics takes some justifying. When I first met the authors, however, I had no hesitation in suggesting to them that what was missing was a rigorous text which did something authors of first year texts seem reluctant to do, namely, discuss welfare economics. I am delighted that the authors took up the challenge and, in my view, succeeded in following through their aims.

The oddity of current ideological standpoints in respect of economics is that a naive philosophy – logical positivism – expounded in its most severe form in the 1920s and 1930s should have such a hold over modern economics teaching. In essence positivism asks us to define the economist's role in such a way that he or she is precluded from making 'value judgements'. The term 'value judgement' is itself a source of confusion but we do not stray too far from a useful definition if we say that a value judgement is almost always expressible in the sentential form 'x is good' or 'x is bad'. The positive economist thus refrains from prescription and recommendation, since such activities imply value judgements to the effect that some event, outcome or activity is good or bad. The most that can be done is to say 'If you (usually some entity called the "policymaker") wish to achieve such and such a result, then my recommendation as to policy is as follows.' In this way the economist is removed from direct association with the end result the policy maker seeks to achieve.

To isolate further the subject of welfare economics, that branch of economics concerned with normative statements to the effect that such and such a course of action *ought* to be pursued, the welfare economist is normally caricatured as someone who 'imposes' his or her own value judgements when normative analysis is undertaken. The end result is a whole generation of economists raised on a false distinction and based on an outmoded philosophy. Much of the harm can be undone in further courses at university or polytechnic level on ideology and on methodology in economics. What the current authors have done is to attempt to reverse the ideological bias that has arisen, and reverse it at an earlier stage than has hitherto been considered. In this respect alone their book is to be applauded as a hoped-for turning point in economics teaching. They may not have gone far enough. My own view is that students can accommodate far more welfare economics than is normally thought possible. Indeed, I would go further and argue that the positivist teaching of economics is one of the dominant factors explaining the widespread image of economics as an arid and dull subject.

The argument that economics is unavoidably normative, inextricably bound up with value judgements, can be rehearsed at a fairly simplistic level. To 'economise' actually means to make the *best* use of resources. But best

## *Foreword*

has no meaning unless it is related to some desired outcome. The best use of resources might be to give them all to me if the underlying value judgement is that my wants and desires are supreme and should dominate. In reality the best use is some combination of an efficiency objective – making sure that we minimise the use of resources for any given amount of desired outcome – and some concept of ‘fairness’ which obviously will vary from person to person. Yet if the very meaning of economics involves a value judgement what becomes of the positivist view that economics ought not to engage in normative activity? Indeed, the irony is that the recommendation is itself a normative statement implying a value judgement about the status of a science.

For these reasons it is a distinct pleasure to see authors facing head-on the efficiency-equity distinction and not shying away from the fact that economics is ultimately about a value-loaded science. What matters is that the value judgements be made clear and that we are given guidance as to how the science would change if a different value basis was used. This helps us to understand, partly, how radical economists can come up with such different prescriptions to ‘orthodox’ economists, although the radicals, in so far as they build upon the works of Marx and others, also have differing positive explanations of relationships between the various actors in an economy. It also explains how economists steeped in ecology can produce different answers to the same questions, and so on. Quite rightly, the authors have not taken us down these paths. The logic of this omission is simple – it is better to build a framework in order to understand the jargon that economists use but to use that framework like a ladder and pull it away when the student is well versed enough to face ‘alternative’ views of society and the economy. What is certain is that repeated avoidance of welfare economics will have the opposite effect.

Finally, the authors have also introduced the student gently to words and issues that some years ago would have been held to be ‘beyond the ken’ of the average student. The constructions that have now been built upon the concept of disequilibrium as opposed to the traditional preoccupation with equilibrium cannot be carried very far in an introductory text. Again, however, the authors have justly used the terminology and explained the basic ideas. In the same way students using this book will come to recognise that the world does not consist of sets of stable equilibria with economies and markets simply hopping from one to the other without any apparent upset. This refreshing recognition of reality may cause some problems – the old economics was easier to hold on to and reassuring in its assessments. The truth now is that economics is undergoing a revolution probably far more fundamental than those that overtook it at the end of the 19th century or in the inter-war years. It would be pretentious of anyone to suggest that this textbook offers reassurance in an unassuring world. What it does do is give some basic insights into the modern way of thinking. It is to be welcomed and, I hope, widely used.

*David Pearce*

Professor of Political Economy  
University of Aberdeen

# Preface

This book has been written with the objective of introducing students to the interesting and important subject of economics. It is intended primarily to be of value as a textbook for students in first-year degree courses in economics, the social sciences, business studies and other areas of study which include economics among their foundation subjects. The material covered is also suitable for many Business Education Council and other professional courses. A careful selection of parts of the book should be helpful to 'A' level students in the United Kingdom and to students of similar courses overseas.

As teachers of economics at degree and higher national diploma level, we have felt for some time that the efficiency and equity aspects of resource allocation have been inadequately treated in introductory textbooks (where the analysis is often omitted completely) and in intermediate microeconomics books (where the topic is normally left until the last few chapters). In an attempt to correct this deficiency, we have included at an early stage two chapters entitled 'Resource allocation' (Ch. 7) and 'Introduction to welfare economics' (Ch. 8): these come *after* chapters on production and demand (which cover isoquant and indifference curve analysis), but *before* the chapters on the theory of the firm, the public sector and the theory of distribution. This lay-out enables us to compare more rigorously the efficiency and equity aspects of different market structures and different policy changes. None the less, much of the material in the chapters on the theory of the firm, the public sector and distribution can be used (with the omission of the welfare sections) by those teachers who prefer the more traditional introductory course. We think, however, that the early introduction of a simple treatment of welfare economics is of great value to beginning students.

An important development in modern economics has been the increasing recognition that disequilibrium, rather than equilibrium, may be the normal state of affairs. As a result, we have attempted to discuss some of the major aspects of microeconomic disequilibrium analysis in Chapters 6 and 15 and macroeconomic disequilibrium analysis in Chapter 23.

Although not intended to be primarily a book on applied economics, there is throughout an emphasis on economic policy. Chapters 11–14 are concerned entirely with the activities of the public sector. Chapter 18 outlines the major macroeconomic policy objectives and Chapters 26–30 are concerned with issues of macroeconomic policy. These sections on economic policy draw heavily on examples from the United Kingdom economy. This does not mean, however, that readers from other countries have been forgotten: in many chapters, there are references to the problems of less

developed countries and, in many cases, statistics are quoted, not just for the United Kingdom, but for a selection of the developed and less developed countries.

Now a brief note on the structure of each chapter. Each one begins with an introduction designed to link the chapter with related ones and to summarise the material to be covered. Each one ends with a brief conclusion, a list of further reading and a set of exercises. As its name implies, the list of *further* reading provides some more advanced references which will take the interested reader to a higher level of analysis than that reached in the text. The exercises are designed to reinforce the reader's understanding of the chapters and, of course, to help in the preparation for examinations. Nearly all chapters have at least one numerical exercise or data-response question in addition to a number of essay questions.

We should like to thank Professor David Pearce for encouraging us to embark on the project. We are also considerably indebted to Stuart Wall whose many comments and suggestions have been extremely helpful to us in revising an earlier draft. For selflessly typing a large part of the manuscript, our thanks go to Jenny Gibbins and Pauline Lever. Finally, special thanks go to our wives for putting up with our over-long preoccupation with the book. We three, of course, bear full responsibility for all errors and omissions.

*Philip Hardwick*

*Bahadur Khan*

*John Langmead*

30 May 1980

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## Introduction

Economics is a social science which seeks to explain the economic basis of human societies. The purpose of this introductory chapter is to identify the basic *economic problem* encountered by all societies and to focus attention on the basic concepts which modern economists employ in their attempts to analyse this problem.

Human existence has been preoccupied with the production and consumption of wealth, the desire for which seems to arise from man's basic impulse to increase his welfare. The concepts of *wealth* and *welfare*, therefore, stand at the heart of economics. A nation's wealth consists of its stock of goods and services – that is to say, it includes tangible goods like cars and houses as well as intangibles like the services of teachers and musicians. Welfare, on the other hand, refers to the satisfaction that an individual or society derives from wealth and can be regarded as being synonymous with that individual's or society's standard of living. If the welfare of one person or group of persons is increasing without at the same time anyone being made worse off, we could say that this is a definite improvement in the welfare of society as a whole. As a criterion for judging welfare changes, though, this is rather too simple because the world we live in is exceedingly complex and most economic changes make some people better off and others worse off. For example, cheap imports of cloth make a lot of people better off as they can buy cloth at lower prices, but many domestic textile workers may lose their jobs and so be made worse off. It is because economic changes generally impose gains and losses on different groups in society that we need criteria of both *efficiency* and *equity* in order to judge policy measures designed to increase social welfare.

In this chapter, we first of all consider the economic problem itself; then we return to the important concepts of efficiency and equity; in the remainder of the chapter, we explain economic concepts like equilibrium and disequilibrium, microeconomics and macroeconomics and we outline the methodology of economic analysis.

## The economic problem

The production of wealth is necessary because it enables individual and collective wants to be satisfied. Unfortunately, wants are virtually limitless whilst the resources to satisfy them are scarce. The most pressing wants are food, housing, clothing and warmth – these essentials are the first to make a call on a nation's resources. Advances in technology and the development of new means of transport and communications, however, have added new wants and brought about new ways of satisfying existing wants. For example,



## Introduction