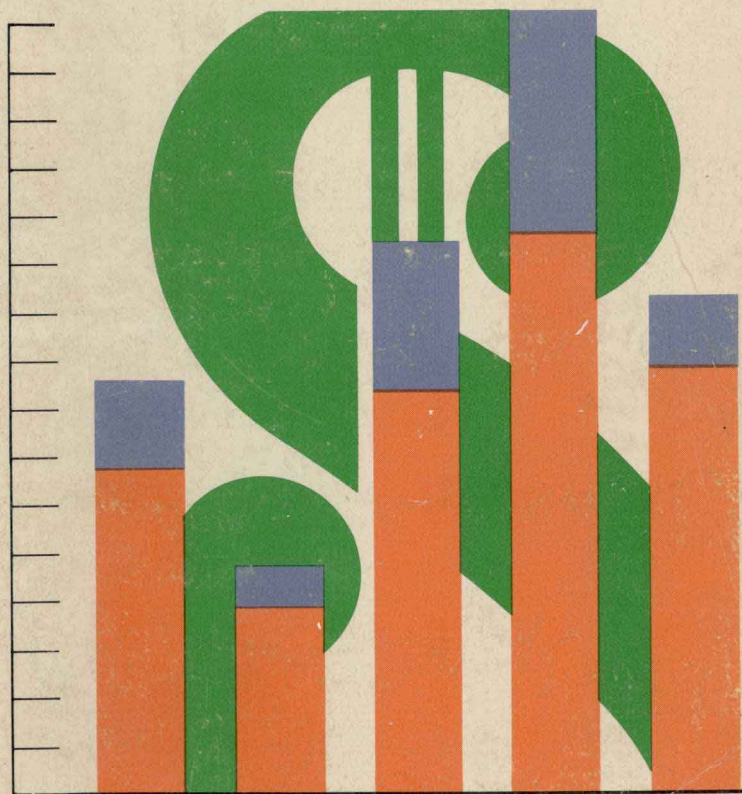


FIFTH REVISED EDITION

An Introduction To Economic Reasoning

ROBINSON ·
MORTON ·
CALDERWOOD



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An Introduction to
ECONOMIC REASONING

BY

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FROM THE FOREWORD TO THE FIRST EDITION

This book on economic reasoning is an introduction to economics for laymen. It is for adults who have a fragmentary knowledge of economic affairs and who seek a framework for more systematic thinking about economic issues. Its purpose is to help the reader explore the meaning of economic events and acquire skills for thinking economic issues through to some conclusion. It is hoped that this treatment will show that economic analysis can assist those who wish to reason for themselves and can help them reach independent judgments respecting economic matters.

The book was originally prepared for the use of adult discussion groups. The topics covered and the length of the volume were dictated by the needs of these groups. In an effort to help them, the authors have attempted to strip economic analysis to its bare essentials. They do not wish to make economic analysis appear easier than it is. But they do believe that laymen with varied backgrounds and experience, who are far removed from college courses and have many demands on their time, need a way to get started on the subject—a way to get into it. They hope that this book will serve to encourage further study.

It is a *way of thinking* about economic issues rather than a full review of economics that is introduced here. The purpose is to show how to examine an economic question, rather than to display the warehouse of economic knowledge that experts might apply. Thus the approach is to present the essentials of fact and formal definition, and to hurry the reader on to a consideration of selected problems on which he may exercise his powers of analysis.

PREFACE TO THE FIFTH EDITION

Nearly twenty-five years have passed since the first edition of this book was published. During its first dozen years, the book went through four editions and was translated into thirteen languages (Arabic, Spanish, French, Swedish, Dutch, Portuguese, Farsi, Japanese, Korean, and four languages of India: Marathi, Hindi, Bengali, and Gujarati; another foreign edition, with a special supplement on the Australian economy, was published in Australia. About two hundred thousand copies of the American edition were sold, and the book continued to be used in college and high school courses long after many parts of it were out of date, because it offered a distinctive approach that appealed to teachers and students.

What encouraged us to undertake this revision after such a long lapse was the recent publication by the Joint Council on Economic Education of *A Framework for Teaching Economics: Basic Concepts*. This report builds on the approach set forth in *An Introduction to Economic Reasoning* and develops it into a very useful teaching tool. Because of the widespread attention given to the Joint Council's report, the case for updating the book seemed persuasive.

In preparing the fifth edition, we have stuck to the basic notion of the earlier editions: to present "a way of thinking about economic issues rather than a full review of economics," and we have also retained the original chapter structure. Some chapters, such as the Introduction, are virtually unchanged, except for the problem. Others, like the chapter on "Economic Growth," which was revised to explore the interrelationships of economic growth, energy, and

With each chapter there are suggestions for additional reading. The materials selected have been chosen for the purpose of helping the reader expand his general background. Therefore those interested in detailed analysis of specific problems will want to look beyond the selections listed. In the belief that an extensive bibliography frequently tends to discourage beginners by forcing them to make premature choices of what to read, these lists have been kept to a minimum. It is hoped, however, that with this beginning, readers will obtain the skill needed to select and read additional economic literature.

The authors and the Brookings Institution are grateful to many members of the economics profession and to the leaders and participants of test groups who generously provided suggestions for the improvement of the book. A special debt is owed to the following people who read and criticized an early draft of the volume: Sumner H. Slichter, G. L. Bach, Horace Taylor, R. A. Gordon, Arthur Upgren, Walter Salant, John G. Gurley, L. H. Kimmel, and Sylvia Stone. The authors' view of the requirements of this type of book prevented them from accepting some of the suggestions that were offered; thus the authors alone are responsible for the final result. . . .

The suggestion that a volume of this sort be written came originally from Mr. C. Scott Fletcher of the Fund for Adult Education. The President of the Brookings Institution proposed the approach followed in this treatment. The Institution is indebted to the Fund for Adult Education for providing financial support for this project. To the authors who have labored to prepare this introduction to economic reasoning, the Institution is especially grateful.

Robert D. Calkins

President, Brookings Institution

January 1, 1956

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the environment, have been substantially reshaped. Inflation gets considerably more attention in the chapter formerly titled "Prosperity and Depression," now retitled "Inflation and Recession."

The Brookings Institution, which sponsored and published the first edition of this book, is in no way responsible for the fifth edition. Though much of the original volume has been retained, the extensive revisions contained in this new edition have been neither planned nor reviewed with the Brookings staff.

In presenting this new edition, we acknowledge our great debt to the Brookings Institution's former president, Robert D. Calkins. He designed the basic approach, offered encouragement, and kept us on track with wise and rigorous reviews of the manuscript for the first edition.

Marshall A. Robinson, who assumed principal responsibility for the first edition, served as reader and critic for this revision. Enough remains of his original contribution to warrant retention of his name at the head of the list of authors, though we absolve him of blame for any errors that we have unwittingly introduced.

Finally, we want to thank the editors at Anchor Books for their patience and support.

James D. Calderwood
Herbert C. Morton

March 1979

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Chapter 1

PROBLEMS AND GOALS

Economic problems are everybody's business because they are part of everybody's life. We read in our newspapers about taxes, foreign aid, strikes, welfare programs, poverty and unemployment, inflation, urban renewal, energy, Medicare, the environment, the balance of payments, the national debt, and many other things. We read of economic problems confronting the community, the state, the nation, and the world. We are urged to vote, to serve on committees, and to be for or against particular proposals that affect economic life. In fact, we are overwhelmed by information, interpretations, appeals, arguments, and advice.

To form opinions on current issues and to make judgments on public problems under these conditions, we all need the help of economic analysis. We need methods by which explanations may be found and alternative courses of action may be evaluated. This is what a study of economics can provide. Economics does not offer ready-made explanations and solutions. Instead, it offers tools and methods for the analysis of economic problems. It leaves to the individual the task of applying these tools and methods to the problems he or she wishes to solve.

This book presents a method of analyzing economic problems. It does not cover the entire subject of economics, but deals only with certain aspects of our own economy. It stresses problems of economic policy and explores them in terms of their effects on the growth and stability of our economy and their effects on the structure of our economic system. It concentrates on such problems and their background in order to show how economic analysis can help the citizen.

WHAT IS ECONOMICS ABOUT?

Economics is generally described as the study of how society produces and distributes the goods and services it wants. More specifically, it examines the activities that people carry on—producing, saving, spending, paying taxes, and so on—for the purpose of satisfying their basic wants for food and shelter, their added wants for modern conveniences and comforts, and their collective wants for such things as national defense and education.

Economics also includes the study of the various ways in which people organize economic life in order to satisfy their wants. These economic systems include not only the American one but also communism, socialism, and such tradition-oriented societies as the peasant villages of rural India and the tribal arrangements of the Amazonian Indians. An economic system can be described as a collection of institutions (such as banks or labor unions), laws, activities, social values, and personal motivations which together govern economic decision-making.

Every society needs an economic system, because the things people want are not provided free by nature. Goods and services must be produced, and the means of production—natural resources, human labor, machines, and other forms of capital—are scarce in relation to the demand for them. Therefore, people cannot have everything they want. They have to make *choices*. They have to decide what to produce now and what to produce later, how to use their scarce resources most efficiently, and how to distribute goods and services among the people. They must also consider whether these choices are to be made by the government, by the free price system, or by a mixture of both.

As a first step to understanding how these choices are made in our society, let us look at our objectives. What do we want our economy to do? What do we want it to be?

THE GOALS OF OUR ECONOMY

The goals of a free society are determined by its people. American citizens are free, within wide limits, to direct their economic affairs so as to serve their personal and social interests. They may save, join a union, buy a car, run a store, and make a variety of other voluntary decisions. Political democracy also gives them a voice in determining the role that government shall play. They may vote for or against a school bond issue. Indirectly, they may influence governmental policies by electing representatives who pass legislation on taxes, foreign aid, control of utilities, the size of the public debt, and other governmental activities. Thus a predominantly free economy and a democratic government give American citizens freedom to determine their personal economic goals and the broader goals that society shall pursue.

Some of these goals are objectives of particular groups; some are objectives for the whole society; and some are objectives that conflict with others. Some are transitory objectives designed to deal with particular problems without reference to the long-run goals of the public.

A few of the more familiar economic objectives are shown in the following list.

Stable prices

Full employment

Market freedom

Freer trade among nations

Protection from the competition of foreign producers

Closer economic ties with our allies

Protection of the environment

Increased energy supplies

Freedom from government restrictions

More aid to the poor, the sick, and the aged

Lower taxes

Increased business investment

Co-operation among economic groups
Increased competition

The full meaning of all these objectives may not be clear at this point, but the list will give an indication of the diverse and often conflicting objectives of the American people. How do we go about reconciling such divergent interests? Are there trade-off points among them on which most people can agree? We shall offer only a tentative answer to these questions at this point. We may begin by looking for a common goal that seems to underlie all the individual and group objectives stated above. What is the broadest economic goal on which we can all agree?

Traditionally, the broad economic objective of the American people has been the achievement of high and rising levels of income and consumption under conditions that afford opportunity for individual advancement and free choice. Of course, we could debate whether having more goods and services will bring greater happiness or greater welfare, but in economics the amount of goods and services produced and consumed has generally been regarded as one suitable measure of economic welfare. This does not mean that economists believe that material goals are more important than other—moral, spiritual, or cultural—goals. But they usually proceed on the assumption that each of us is the best judge of what will best serve his or her own welfare. They assume that our actions indicate how we seek our goals.

In general, therefore, the economist assumes that income and consumption can be used as the principal measure of economic welfare because people have shown that they are willing to use their effort and ingenuity to produce things for their material satisfaction. But in every society there are economic, cultural, and moral limits to people's desires for more income and consumption.

In recent years an increasing number of people have come to believe that economic growth must be consistent with other, more "social" goals, such as an improved quality of life, a cleaner environment, safer working conditions, and equal employment opportunities for women and minorities. These "new priorities" are having a significant effect on the

functioning of our economic system and on the achievement of our goals. In addition, what we do to achieve today's economic goals—more wealth for those now living, for example—must be consistent with the preservation of resources for the use of future generations. In this book, however, we shall concentrate on the economic conditions of welfare, leaving to others the larger task of defining what constitutes "the good life."

Greater income and consumption are only the first ingredients of "economic welfare." A number of other requirements must eventually be added to arrive at a full definition of this goal.

How are goods and services to be shared by the people of a society? Is an equitable distribution of income (however that may be defined) a goal of our society?

A complete definition of economic welfare must also include some concept of how much people should work. Should people have to work six or eight or fourteen hours a day? How important is leisure? Should everyone, including children and the aged, have to work, or should certain groups receive income without working?

The definition of economic welfare must also include some notion of what kinds of goods and services should be produced. Are some goods and services better than others? If so, which? Should the production of some goods (for example, saccharin) be prohibited? If so, which? The pattern of production will also be influenced by the relative importance of other goals, such as better health or a cleaner environment.

The decisions involved in defining "economic welfare" are the basic economic decisions confronting every society. What goods and services should we produce and how should we produce and distribute them so that we will get the maximum yield from our efforts? In the Soviet Union or in Italy (or in any other country) these decisions are made differently than in the United States. And in the United States they are made differently today than they were a century ago or even thirty years ago. The reasons for these differences will be explored in subsequent chapters. Now, however, it will be useful to obtain a general idea of how

these decisions are made in the United States at the present time.

HOW DOES OUR ECONOMY PURSUE ITS GOALS?

One of the important characteristics of the American economy is its strong reliance on individual economic decisions. For this reason it is frequently given the name “private enterprise system.” This term implies that individuals can usually choose their way of earning a living; they can save or consume as they see fit; and they can pursue their personal goals even when they do not conform with those of society as a whole, as long as they do not unduly hinder important social goals or the freedom of others.

How this unplanned and unregulated economy might function successfully was first explored systematically more than 200 years ago by a Scottish philosopher, Adam Smith. In his *Wealth of Nations*, Smith argued that most people are primarily concerned with their own interests (that is, they want things for themselves, their families, or their communities). He also noted that if people will specialize in their work and exchange the fruits of their labor with one another, everyone will be better off. He argued that the individual could best help himself by producing the things that other people want. Thus with individuals free to show what they want by the prices they are willing to pay, producers would tend to supply the things demanded by the public. Free competition, together with a price system that reflected the desires of consumers and the capabilities of producers, would, he argued, bring order and efficiency to an economic system.

Smith recognized that a free economy needs “rules of the game”—and the government must be the umpire. When individuals combine forces to get the better of someone else, or when other private restraints are put on individual competition, the self-interest of one individual may actually harm the rest of society. Hence he argued that one of the necessary functions of the government in a private enterprise system is to control restraints on competition. With the passage of