

# INTRODUCTION TO **ECONOMIC**

An Integrated Approach to Fundamental Principles

JOHN CRAVEN

# Introduction to Economics

*An Integrated Approach to  
Fundamental Principles*

John Craven

Basil Blackwell

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# Introduction to Economics

# Preface

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This book is the product of a number of years of teaching introductory economics to university students, and of increasing dissatisfaction with the tendency in most introductory courses to divide the subject into two parts, macroeconomics and microeconomics. This separation is confusing to students, many of whom continue to believe that economics is, in effect, two subjects that have little in common.

This book attempts to build macroeconomic conclusions on microeconomic foundations, and the chapters on microeconomic topics and the chapters on macroeconomic topics do not appear in separate sections of the book. Instead, the book is divided into parts, each of which involves both macroeconomic and microeconomic topics. Part I introduces some basic concepts and methods. Each following part deals with both microeconomic and macroeconomic aspects of increasingly more complex and more realistic economic systems. Part II examines a simplified market economy and part III a more complex economy; part IV looks at a mixed economy and part V an open mixed economy. To a large extent, therefore, each part builds on those that have come before, although it is possible to work through the book omitting, or considering only briefly, some of the intermediate chapters. A course can be devised that covers the material of some of the chapters without taking too much on trust, and without losing the message that economics is a single subject that fits together in a coherent and interesting way. Such a course should include part I as a basic requirement, and chapters 8, 11, 12, 15, 16, 17, 19, 23 and 24. The addition of the remaining chapters of parts II and III reduces the extent to which such a course leaves out the foundations of macroeconomics and of economic policy in market economies.

The only mathematical background required is the ability to cope with very simple algebra – little more than the use of notation for clarity and simplicity. A few topics, dealt with in separate boxes, require more mathematical background, but none of these topics is essential, and they are included mainly to illustrate the variety of ways in which mathematical methods can be used in economics.

Each chapter ends with a number of topics for discussion, and most chapters include some problems. The topics extend the discussion and seek opinions on the merits of policies that might be used, and the problems illustrate the techniques used in the text. Answers to numerical problems are provided at the end of the book.

The glossary of the main terms can be used both for reference and for revision: it contains a number of important terms with which students should be familiar. Of course, such a glossary cannot explain how the terms are used in any detail, but it can help to list the major ideas and concepts that are needed to study economics.

I owe an enormous debt of gratitude to my teachers, and to colleagues and students both at the University of Kent, England, and at the University of Guelph in Canada, where much of this book was written. I cannot mention all who have influenced me, but I am particularly grateful to Colin Cannon, Jim Hughes, Bill Smith, Clive Southey, Tony Thirlwall and Roger Vickerman, who supplied information and made many valuable suggestions. Richard A. Powell, Nancy Wall and Eileen Robertson read an early version of the text, and are responsible for a great many improvements in the content and the style.

Ingrid Devisser, Anita Leunissen and Nicola Garrish typed with efficiency and speed – and without complaining about my atrocious handwriting. I am grateful to Phil Gould and to David Foscitt for finding and supplying a word processor, and for redeeming it when I corrupted it. René Olivieri and Tony Sweeney of Basil Blackwell provided patient help and encouragement – and remained committed to a project that may sometimes have appeared less than hopeful.

Three people have made an enormous contribution to the final version of this book. Donna Murray read, criticized, typed and researched efficiently and with great perseverance, and to her I am grateful for many of the tables and other data. Alan Carruth and Richard Disney read through the whole of the final draft making valuable suggestions, and rescuing me from a number of involuntary errors. They did this during a very busy term, sacrificing their own time for my great benefit. I am very grateful to these three people, although they are entirely absolved from errors and obscurities that remain. These are my own responsibility.

Finally, and most important, my thanks to Laura for her assistance, encouragement and support on the bad days as well as on the good, and to Matthew and Rebecca, for being there.

# Author's note

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The sources of information used are listed in the bibliography. One billion equals one thousand million. The final digit of a figure may have been rounded up or down. Official statistics are revised (often for several years) after they first appear so that those used in this book (generally published autumn and winter 1983) may not correspond exactly to those published later.

For Laura  
with love and gratitude  
beyond all measure



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## Chapter One

# Scope and method of economics

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What is economics? — methods in economics — individual behaviour — assumptions and models — value judgements

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### 1.1 Introduction

No one comes to economics as a traveller to an unknown land. Much of our everyday experience is of economics: spending money, budgeting, looking for jobs, working, paying taxes, collecting pensions, voting and arguing about ‘what the government should do’ all involve economics, and all involve topics discussed in this book.

The familiarity of the subject matter has an advantage and a disadvantage. The advantage is that studying economics is extremely relevant to very important issues that involve everyone. This book discusses unemployment, inflation, wages, poverty, taxes, banks, nationalized industries, foreign currencies, aid to less developed countries and a great number of other important topics. The disadvantage is that everyone who studies economics comes to the subject with opinions based on their past experience, and on their political and moral beliefs. On some occasions it is difficult to separate differences of opinion on what *should* be done from differences of opinion about what *can* be done. In principle, these two are separate sources of debate: for example, people disagree about whether the government *should* attempt to reduce the inflation rate by limiting wage rises, even though they may not disagree about whether limiting wage rises *does* reduce the inflation rate. In political argument, however, this distinction is often blurred.

Thus a very important aspect of the study of economics is the attempt to examine what does happen in certain circumstances without allowing views of what should be done to intrude. This does not mean that all economists agree on the consequences of an event or government policy. In this book we shall see that there is a variety of views on a number of extremely important economic problems. This variation in views stems not from differences of opinion about what should be done, but from differences of opinion about what happens.