

Preface

“...by directing industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases led by an invisible hand to promote an end which was no part of his intention. Nor is it always worse for society that it was no part of it. By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it.”

Adam Smith, *The Wealth of Nations*, 1776

This book is an introduction to economics for university students. As the name “political economy” suggests, the book differs from other introductory texts in emphasizing connections between the organization of the economy and the conduct of government, but, like every other introductory text, its primary focus is upon the calculus of self-interest in the everyday business of life and upon the workings of the economy itself. The book is intended to whet the student’s appetite for the study of economics and to supply a foundation for more advanced courses in the subject. It is also intended to convey the lessons of economics that will prove most useful to the student - whose main interest may lie in other subjects and who may not continue the study of economics - in his role as citizen, voter and participant in the governance of society. Somewhat more difficult than other introductory texts, the book is no more difficult than introductory texts in the sciences. As the text for a full-year introductory lecture course, it should be comprehensible enough.

The book would also serve as a text for a second-year course in political economy narrowly defined, with emphasis on the economics of voting, public administration and law. The chapters on markets and the competitive economy would then constitute a review of essential background material.

The main purpose of this book, like that of any introduction to economics, is to explain the price mechanism: how market prices emerge spontaneously and how these prices create “order without orders” allowing the world’s business to be conducted without any central authority to direct the process in detail. One might suppose that nothing less than an all-powerful central authority would be required to direct millions of people producing a virtually infinite variety of goods, to align production to consumption so that the mix of goods produced is precisely the mix of goods people want to consume, and to determine each person’s share of the pie. Surprising as it may seem to people unacquainted with economic ideas, that turns out not to be so. Instead, with private ownership of the means of production but without central control or conscious planning of the economy as a whole, self-interested people are guided by market-determined prices to deploy the resources of the world to produce what people want to consume. This assertion, made commonplace by repetition, is so extraordinary and so completely counter-intuitive that it cannot be strictly and unreservedly true. A central task of economics is to show when the assertion is true, when public intervention in the economy might be helpful, and when markets are best left alone because public intervention is likely to do more harm than good.

A second objective is to introduce the student to the tools of economic analysis. Demand and supply curves are derived in a simple framework and are then applied to the task of showing the consequences for the economy of monopoly, tariffs, patents, technical change and alternative forms of taxation. Demand and supply curves facilitate the analysis of the role of the government in the economy, why some countries are rich and other countries are poor, how to foster economic growth, how to reduce the gap between the incomes of the rich and the poor, when to regulate markets, when and how to reduce the level of pollution, how to identify the pros and cons of public provision of health care and education, and how to determine the appropriate public provision of the infrastructure of society - roads, bridges, the army and basic research - that a market might not supply at all.

Third - and here is where a text on political economy differs most from other economics texts - a text on political economy emphasizes the mutual dependence of economics and politics, how the virtues of a competitive economy are conditional on other institutions in society and how economic organization may foster or corrode democratic government. Perennial questions of political economy are discussed: How can the personnel of the army and the bureaucracy - endowed with a monopoly of the means of organized violence to protect citizens from one another and from aggression abroad - be deterred from employing its authority to transform itself into a ruling class that exploits the rest of society for its own prosperity and advantage? Throughout most of history, that is exactly what happened. Why is this outcome avoided in some countries today? How can democracy with majority-rule voting be sustained when a majority of the poor can employ the power of the vote to expropriate the rich? What is to prevent a majority based upon race, language, religion, locality or any badge whatsoever from exploiting the remaining minority of the population? Until a few hundred years ago, it was generally believed that democracy had no defence against expropriation of minorities by majorities, and democracy was widely opposed on that account. Why, though some capitalist societies are not democratic, has no thoroughgoing communist society, with full public ownership of the means of production, ever been democratic, despite the intentions of its founders? A text on political economy would be expected to raise these questions, even if no definitive answers can be supplied.

Political economy is the original name for economics, abandoned a hundred years ago for the simpler term "economics" because the content of the subject had narrowed. The word "economy" is derived from a Greek word meaning "the management of the household". Political economy would be the management of the nation. In the nineteenth century, and frequently in the first half of the twentieth century as well, what we now call economics and what we now call political science would be studied under the heading of political economy in the same department of the university. Over the last fifty years, the unified departments split into individual departments of economics and political science, as each subject acquired a separate domain of investigation and a distinct style of analysis. The economy came to be studied entirely on its own, as a great machine that reacts to political decisions about such matters as tariffs and taxes but that runs entirely in accordance with its own laws of motion.

Just as the divorce seemed complete, there emerged on the horizon new problems that straddled the two disciplines. It became evident that voting could be usefully analyzed by methods that have more in common with economics than with political science as practiced at the time. The study of voting became the domain of scholars who may have started out as economists or as political scientists but who needed familiarity with both disciplines. It became evident that economic growth was as much a consequence of political organization as of conditions in the economy. It became evident that society's choice of laws could be explained on the same economic principles used to explain society's choice of roads, bridges, hospitals, and schools. It became evident that democratic government and civil liberties were intimately connected with the organization of the economy.

Nowadays, the term political economy may refer *either* to a sub-field of economics about overlaps with politics and law *or* to the entire field of economics broadened to include the overlaps with politics and law. Political economy may be an increment or an expansion. In this book, it is an expansion; it is economics with a political slant. The study of how markets supply goods and promote economic growth (the traditional domain of economics) is combined with the study of how markets depend on other institutions in society and of how, together, property, public administration, voting and the law uphold what most of us see as a good society.

The broadening of a field of study may or may not be desirable. In some grand sense, all knowledge is one, but we compartmentalize knowledge into fields such as physics, chemistry, biology, economics, political science and philosophy for the same reason that different people do different jobs. The world's work is best accomplished by a division of labour in learning as well as in toil. But boundaries between fields of knowledge are not fixed forever. They change from time to time in response to new interests and new discoveries, as, for instance, when psychology split off from philosophy or when biology and chemistry gave birth to bio-chemistry. Whether it is useful to recognize something called political economy is in the end a question of how best to develop the student's understanding of society. A course in political economy may be a good beginning for the study of economics and a way to whet the student's appetite for economics more narrowly defined. Whether he begins with conventional economics or with political economy should make little difference by the end of a solid three or four year program.

It is customary to teach economics by telling little stories to illustrate the main ideas of the subject. Here, the practice (or vice, depending on how you look at it) is carried to the extreme. Predatory behaviour is introduced by the story of the fishermen and the pirates. The interaction of taste and technology is illustrated by the tale of Robinson Crusoe. Prices and markets are introduced in an economy with five people, each with his own plot of land. Problems in majority-rule voting are exemplified by a choice among sandwiches, the apportionment of the national income, the construction of five roads in five regions of the country, and deals in the legislature between militarists and egalitarians. The five roads reappear in the discussion of public administration, together with a story about safety in airports and bus stations. The examples are mostly numerical rather than analytic. They rely more upon made-up numbers rather than upon smooth curves or functions. By comparison with other introductory expositions of economics, the style here is old-fashioned, less general and sometimes open to the suspicion

that different numbers might have yielded a different story; but it allows for the presentation of ideas with much less recourse to formal mathematics. The examples are intended to convey economic ideas forcefully and memorably, supplying the student with templates or paradigms that can be applied in a variety of circumstances. After studying this book, a student of economics would proceed to solid, rigorous texts in microeconomics and macroeconomics.

The reader is expected to be familiar with high school algebra but not calculus, though some calculus ideas are developed from first principles. The student with no calculus at all will acquire a little familiarity with calculus ideas which should be of some help when he comes to study calculus later on. The student with a little calculus will follow the demonstrations more easily and will have his grasp of calculus strengthened by its surreptitious application here. The student with a strong foundation in calculus will be able to skip some demonstrations as obvious.

Chapter 1 is intended to motivate the student for the study of political economy. It calls attention to how extraordinarily fortunate we are to be living in this particular time and place, automatically raising the question of how prosperity and freedom are attained. People today - primarily, but by no means exclusively, in the capitalist democracies of Europe and North America - are enormously better off in virtually every respect than people have ever been before, with a higher standard of living, greater variety of goods, much longer lives, less pronounced inequality of income, status and rights, the elimination in most countries of torture and slavery, and greater influence of ordinary people upon the choice of leaders and the conduct of government. The common opinion that the twentieth century has been especially prone to devastation in war and civil strife is debatable; and the deficit of mortality, if any, on that account is almost certainly outweighed by the alleviation of ordinary starvation and disease. A statistical summary of these advances in prosperity, longevity, and other aspects of society leads naturally to the study of whether and to what extent the competitive economy is a necessary condition for economic, political and social progress.

Chapter 2 is about predatory behaviour. The chapter may be seen as presenting a dilemma or riddle to be solved in the rest of the course. Life in a society without strong government is "solitary, poor, nasty, brutish and short." Resources and energy may be diverted from the production of useful goods and services to the struggle over the allocation among people of the goods and services produced. Government strong enough to contain private exploitation is also strong enough to exploit the common man in the interest of a ruling class, as a shepherd exploits his sheep, allowing neither liberty nor progress. The picture of government as predator leads naturally to the study of how a competitive economy might serve to constrain and humanize the potentially corrosive powers of government.

The next five chapters are a simple, self-contained account of the mechanism, the virtues and the weaknesses of markets with private ownership of the means of production. Chapter 3 is an almost unconscionably brief description of the competitive economy. It is the story of the invisible hand referred to in the quotation from Adam Smith above. It is the story of how prices govern production and allocation of goods, determining at once how scarce resources are deployed, what is produced, and how goods are allocated among people. The principal tools of

analysis are the demand curve as a reflection of taste and the supply curves as a reflection of technology. These are introduced in an economy with only one person who produces two goods on five plots of land with different productivities. Then, after a brief digression on bargaining, the five plots of land are reassigned to five different people, allowing for the emergence of a competitive market where prices guide production and trade. Simple as they are, these models are sufficient to display the virtues and vices of the competitive economy and to show how markets enable most of the world's work to be done and most of the national income to be allocated without detailed and comprehensive direction by a central authority.

Demand and supply curves are a flexible and versatile tool of analysis. In Chapter 4 they are put to work in measuring the gain from trade, the full cost of taxation, the social loss from monopoly and social gain from invention. Taste and technology are studied in more detail in chapters 5 and 6. Chapter 5 is about the diversity of types of goods and the implications for the role of government in society. Chapter 6 is about how different types of resources are combined to produce goods and about the sources of economic progress. Chapter 7 is about how people bargain and about how associations - corporations, trade unions, and political parties - supplement or circumvent markets when direct bargaining is prohibitively costly. The world's work is facilitated by a combination of price-taking and deal-making. The clean implications of price-taking in the simple economy discussed in the earlier chapters require considerable modification once bargaining is required.

The benefits of a competitive market are realized because, and only to the extent that, property is secure. Security of property is typically postulated in expositions of economic analysis. The postulate is often valid in practice, but never completely so and always because other institutions in society create an environment where markets can flourish. These institutions and their connections with the economy are the subject of the last four chapters. Chapter 8 is about criteria for economic policy. We cannot reason with one another about laws, rules or policies without some generally recognized notion - however vague or imprecise - of the common good, but there is, unfortunately, no unambiguous and universally acceptable measure. An attempt is made to be as precise as possible about the common good and its implications for economic policies or institutions. Chapter 9 is about voting. People nowadays are inclined to think of voting as unambiguously righteous, but it turns out, on close inspection, to be much more problematic than is often supposed. Voting supplies laws and leaders, but could itself become the instrument by which one group of people exploits another. The emphasis of the chapter is on how this dismal outcome is in practice averted. Diseases of voting (the reasons why government by majority-rule voting may self-destruct) and defences of voting against disintegration are examined. Chapter 10 is about administration. Not all public decisions can be made by voting. The army, the police, the roads, the redistribution of income, and, in most societies, the hospitals, the schools, and many other aspects of life are publicly administered. Public administration requires detailed regulation that can only be supplied by a hierarchically organized bureaucracy that may turn despotic unless confined by clear principles of governance that only the legislature can provide. Cost-benefit analysis is discussed as a surrogate for the common good and as an defence against excessive discretion by the bureaucracy.

The final chapter is about how the law protects property and preserves the environment for majority-rule voting by punishing crimes, adjudicating disputes and guarding a constitutionally specified line that no administrative apparatus and no legislature may cross. Law is the guardian of rules that would otherwise be violated and misused. For product liability and for murder, it is shown how, and to what extent, laws can be designed and evaluated with references to their consequences in promoting the common good. The chapter ends with a discussion of cases pertaining in one way or another to civil rights and to the role of the courts in interpreting the constitution.

Two large interconnected themes run throughout the book. The first is the distinction between economic rights that people hold unequally and political rights that people hold equally. Economic rights are entitlement to property acquired by inheritance or by purchase. Political rights include the right to vote, to equal treatment under the law, to equal access to public education, to run for office, and so on. These rights clash at the edges. They clash over the progressivity of the income tax, or, more generally, over society's decision about how much of each person's earnings are his own to spend as he pleases and how much are to be shared with the community at large through tax-financed redistribution of income, welfare for the poor, the old age pension, unemployment insurance, public provision of health care, and so on. The clash between these rights is at the root of an ancient objection to democracy, the fear that the right to vote will be used by the poor to expropriate the rich, destroying prosperity and democracy in the process. These rights are studied together in contemporary political economy.

The other major theme is the mutual dependence of private property, voting, administration, and law. Together, these institutions constitute the foundation of what we see as the good society, defending us against anarchy on the one hand and despotism on the other. Though the competitive economy is often studied in isolation from political institutions, it cannot really stand alone because private property cannot defend itself. Property is a creature of the state. None of the virtues of a competitive economy can be realized without public administration to protect property rights, compensate for the "failures" of an unfettered competitive economy, redistribute income to some extent, and supply types of goods that markets can never supply. The law specifies the boundaries between people's property rights, resolves disputes and protects people from predatory government as well as from one another, tasks that the law cannot perform without some degree of independence for the judiciary. Voting is required as the only alternative to despotic government. But the defence is not just one-sided. Our political institutions cannot cope with the allocation among citizens of the entire national income, and can only be maintained in conjunction with an economy where most of the allocation of income to people is outside the political arena. The consensus in society to accept the will of the majority in voting, the decisions of the bureaucracy and the judgments of the courts as binding on each of us could not otherwise withstand the pressure of self-interest.

Dan Liang, now a graduate student in the Queen's School of Business, prepared the diagrams and assembled most of the data on life expectancy in Chapter 1. Jill Hodgson, my secretary, miraculously preserved her cheerfulness and her sanity through revision after revision of the text. My colleague Marvin McInnis, proved an inexhaustible source of information about the matters discussed in this chapter. Charles Beach, Caroline Miller, Jim Pritchard, and Lucien Karshmar suggested sources of data. Suggestions by Barbara Goldberg have been incorporated in the chapter on law. Thank you all. For more years than I care to admit, the economics department at Queen's University has provided me with a pleasant and challenging environment for research and writing. The Social Science Research Council of Canada provided financial support.