

ECONOMIC ANALYSIS



ECONOMIC ANALYSIS

By

Kenneth E. Boulding



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To

ELIZABETH ANN BOULDING



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PREFACE

THE purpose of this book is twofold. It is intended as a text from which the student can learn and the teacher can teach the methods and results of economic analysis. It also seeks to be a contribution to the development and systematization of the body of economic analysis itself. These purposes are not separate. The task of presenting a systematic, orderly, and accurate account of economic analysis is identical with the task of preparing the material for teaching. It must be emphasized, however, that the purpose of this work is not primarily to entertain the student, or to enable him to regurgitate appropriate material into examination books, or to learn a few pat phrases, or to indoctrinate him with an abstract discipline which he will never use. Economics is like photography in this respect, that underexposure is less desirable than no exposure at all; and it is to be feared that too many half-exposed students are produced by our institutions of higher learning. The picture of economics held in their minds is a blurred and confused one, and what they have learned is not sufficiently accurate to serve as a tool for the analysis of practical problems. It is hoped that the student who survives this book will at least have come to regard economic analysis as a discipline useful in the interpretation and solution of numerous problems of life and thought, and will be able to add its methods to the cutting tools of his mind. Hence this is a work for the serious student, and not for the course-taster.

Economics presents a peculiar problem of exposition, in that its various parts are much more closely related than is the case in many studies. Unless the student catches some vision of the whole great globe of analysis, therefore, he is likely to miss the significance of each part that he studies. It is the experience of most economists that on first approaching the subject it seems

to be a hopeless confusion of unrelated principles. After a certain period of study, however, it may happen that the student experiences an illumination, often quite sudden, of the true nature and relationships of the subject, and from that time forth every part that he studies falls into its proper place and the subject is seen as a closely integrated whole. For this reason I have divided the work into two parts, each of which contains about enough material for a half-year's course of study. In the first part I have endeavored to range over the whole field of economic analysis, using the simplest possible weapons of analysis, so that the student may obtain a rough outline of the whole picture. In this part, therefore, I treat the concepts of demand and supply curves as self-evident, without discussing the marginal analysis which underlies them. With the concepts of demand and supply as the principal instruments of analysis, I outline the main principles of price determination and of distribution. In this part also I consider the theory of money, banking, international trade, and the business cycle, still confining myself to the tools of demand and supply.

In the second part I give in detail the marginal analysis underlying the demand and supply curves, including the theory of the individual firm, of consumption, of imperfect competition and monopoly, together with a discussion of the theory of capital. With the foundation laid in Part One the student will be able to integrate this more difficult material into his studies as he goes along. In this part I have followed the practice of segregating the more difficult material into separate chapters. Hence this part can be studied on two levels: the student can go through it on an elementary level, or he can take the more advanced material in his stride. (See page 376.)

The arrangement of this work thus is not according to subject matter, as usually seems to be the case, but according to the methods of analysis used. The old fourfold division—production, consumption, distribution, and exchange—has almost completely disappeared. Instead we have a twofold division: into the part of the analysis which can be conducted with the aid of the demand and supply concepts, and the part that requires the

concepts of the marginal analysis. A surprising amount can be accomplished with the aid of demand and supply analysis alone. Determination of prices, the elementary theory of distribution and exchange, the elementary theory of money, international trade, and the business cycle can be discussed without once using the word "marginal." Therefore, this word so full of torment for the beginner does not occur in Part One. In Part Two all this analysis can be elaborated; demand curves can be derived from utility or from production functions, supply curves from cost curves, and the whole theory of the individual firm can be worked out. A possible defect in this method is that the theory of monopoly and imperfect competition must be postponed to Part Two. Nevertheless, there are sound reasons for this; a student who is introduced to the modern theory of the market and the individual firm before he receives a thorough grounding in supply and demand analysis is often inclined to lose sight of the broad principles governing the whole economy through his absorption with the study of special cases. The conclusions of the analysis of perfect competition are modified, but not superseded, by the introduction of more complex and realistic assumptions; and the student will perceive more clearly the implications of these modifications if he knows what they modify.

The method of this work, therefore, is somewhat new; it may be called the "implemental" method, as it seeks to classify the various topics of analysis according to the analytical tools or implements used. It is thus hoped that the student will come to regard these tools as instruments, not as playthings. To this end I have introduced a system of discussion of practical problems which has, I believe, some claim to novelty. Instead of having one volume on "principles" and another volume on "problems," as is usually the case, and where all too frequently the "problems" have little or nothing to do with the "principles," I have integrated principles and problems throughout. That is, after each theoretical section in which the student has been introduced to a tool of analysis, there will be found a section dealing with those practical problems to which the tools thus far

acquired can be applied. For example, after the chapter on the determination of prices in a competitive market, I discuss immediately the practical problems of organized competitive markets, such as the foreign exchange market, the capital market, and the commodity markets. After the section on normal demand and supply curves I have two chapters of problems which may be solved with the aid of these concepts, and so through the book.

In selecting these problems I have sought to choose those which provide the best illustrations of the principles involved, rather than those whose interest centers merely in their topicality. It is my belief that a work on principles should compete with neither the popular magazines nor the encyclopaedias. Consequently I have not endeavored to write a compendium to current economic problems, for the reason that by the time the student has to face economic problems those of today may no longer be current. It seems to me more important to give the student a training which will fit him to understand the problems of the world of his maturity rather than of his youth. Consequently it is more important to give him a rigorous training in methods of analysis than to prime him with personable current opinions. It also seems to me that it is unwise to crowd a principles course with masses of factual material in special studies—labor, marketing, etc.—merely for the sake of giving the work an air of factuality. The place for such factual studies is later in the student's career, when he has acquired the techniques for interpreting the monstrous riddle of the factual material.

No advanced mathematical knowledge is required for this work. A knowledge of plane geometry will carry the student through all except the advanced chapters in Part Two. Even in these chapters a nodding acquaintance with solid figures is all that is required. Any material involving algebra or the calculus is carefully segregated in appendices.

K. E. B.

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March, 1941.

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