CURRENT DEVELOPMENTS IN ECONOMICS

Current Developments in Economics

STEPHEN C. R. MUNDAY

Foreword by G. C. Harcourt

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Foreword

Teaching economics well at any level is a great challenge and at an introductory level probably the greatest challenge of all. To achieve effective success, the reading set needs to be authoritative, balanced, lucid, applicable to the world around us, especially as perceived by the students involved, *and* exciting and inspirational. By writing down this list, I have described Stephen Munday's splendid *Current Developments in Economics*.

I had the privilege, first, of lecturing to Stephen when he was a student at Cambridge in the 1980s (I also played cricket against him), and secondly, of seeing a lot of him and of reading his book in embryo when he was school teacher by fellow at Selwyn in 1994. I learnt a great deal from all these encounters.

Stephen really is the master of his subject. His range is wide; he sees his subject as a means to understand the world, why it works well and badly, and what may be done about it. He is a humane and generous person and these traits inform all that he does and writes. He has a good sense of the nature of political constraints and of the limitations of economic analysis itself. Within these constraints, he has written a book which guides the reader, carefully and with mounting enthusiasm, through current developments in economic analysis and their applications to the pressing economic and social problems of our age. I cannot recommend too highly this excellent introduction to what is still a fine calling, worthy of the attention of all those with cool heads and warm hearts, as Marshall put it long ago, who care about their fellow citizens and their society.

G.C. HARCOURT

*Reader in the History of Economic Theory
Fellow, Jesus College, Cambridge
Professor Emeritus, University of Adelaide*

Acknowledgements

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I am very grateful to Tony Thirlwall for commenting extensively on some early proposals that I had about the book and for the several various helpful suggestions that he made about its structure and content.

During my research I found particular books and articles especially helpful for different topics. The *Oxford Review of Economic Policy* is an outstanding economics journal, and I found the review articles on several of the topics that I was handling particularly helpful. I would recommend them to anyone studying economics. Robert Heilbroner's *The Wordly Philosophers* is an excellent summary of the thoughts and ideas of most major economists, and I found the book particularly helpful for the chapter on the history of economic thought. Geoff Harcourt's lecture notes on the topic were also very useful. I found Bronwyn Croxson's lecture notes on the economics of health care particularly helpful for the chapter on the state provision of goods and services.

I am grateful to the Brookings Institution for permission to use the table on the estimated effects of inflation and unemployment upon government popularity in the chapter on economics and politics.

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Finally, I owe a great debt of gratitude to my two young daughters and especially my wife, Elizabeth. I sometimes wondered if the opportunity cost of the project was too great and without Elizabeth's tolerance and encouragement the book could never have come into existence. Thank you.

STEPHEN C.R. MUNDAY

Introduction

This book aims to be an economics textbook with a difference. It does not aim at anything approaching universal coverage of the subject matter of economics. Topics such as the basis of supply and demand theory and the different competitive models in the theory of the firm are hardly mentioned. As such, it is in no way intended to be a substitute for a sound, basic economics textbook. Rather, it is designed to complement such texts. The purpose is to pick on issues within economics that either are often insufficiently covered or entirely neglected in many of the standard textbooks, or where there have been important new developments in the relevant economic theory which have generally not found their way into the textbooks. Often, such developments occupy much space in the standard economic journals and form an important part of many economics and related subjects degree courses. However, they are rarely found in a general textbook. The aim of the book is thus to bridge that gap.

Within that overall aim, this book has certain other principles. The general approach of each chapter is to take a topic of interest and importance in the study of any economics course. The relevant theory concerning that issue is then explained, often with two sections, one summarising what might today be called the 'traditional' economic theory and the other then considering relevant new theory in that area. Once this is done, topical case studies are chosen to which it is possible to apply the relevant theory. Where possible, the implications for government economic policy are also considered. The suggestion is thus that the economist can arm himself or herself with certain important principles and theories which can be used as a lens with which to view a whole host of important issues in order to aid understanding and analysis. The book also aims not to use any mathematical language. The logic and significance of the theories in economics can be appreciated without having to be expressed in a language that remains foreign to many who endeavour to study the subject of economics. Thus those who are uncomfortable with mathematics should be entirely comfortable with the approach of this book (as indeed should those who do feel comfortable with mathematics!).

The book is divided into three separate sections. Part I, an overview of economics, is in some ways an introduction, but more a look at three overarching fundamental issues in the study of economics which are generally virtually entirely ignored in most standard economics textbooks. The first concerns economic methodology (Chapter 1). The general tendency is to dive into the subject content of economics without considering how the subject should be studied and used. This chapter looks at the issues involved. Chapter 2 attempts the ambitious task of giving a brief overview of the history of economic thought. So often economic theory and practice is better and more fully appreciated within its his-

torical perspective, yet this is equally often simply ignored. Chapter 3 addresses the standard divide in the subject of economics between microeconomics and macroeconomics. Usually, the difference between these is defined in economics textbooks, and then they are treated as almost entirely separate subjects. The problems with this are discussed, as are the reasons why the two must be seen as a coherent whole.

Part II of the book picks on various topical issues within the subject of economics which are usually seen as part of microeconomics. Game theory has received great attention in the study of economics in recent years, but little of this has found its way into the standard economics textbooks. Chapter 4 attempts to overcome that problem. Privatisation is an issue that does appear in many textbooks, but Chapter 5 here looks at relevant theory that is less frequently considered and discusses how its application is relevant to the topic. The environment is an issue of particular current concern. There is much important and relevant economic theory that can be applied here, and that is what Chapter 6 attempts to do. Consideration of the rationale of the government provision of goods and services goes to the heart of important theory and theoretical differences within economics. The whole range of relevant economic theory, both old and new, is considered and applied to the topics of health care and education in Chapter 7. Taxation is a political hot potato, but Chapter 8 on this topic looks at how a proper understanding of the relevant economic theories can help to clarify and to understand what are the important issues at stake. finally, Chapter 9 on the economics of trade looks at new trade theories that challenge the standard theories of trade which form the usual presentation of economics textbooks.

The final section of the book, Part III, examines some of the fundamental and topical issues within the area of macroeconomics. All standard textbooks look at some or all of the macroeconomic models that are available for studying the subject. However, the purpose of Chapter 10 is to put the different models side by side and to consider which issues are best understood through which models, and what are the shortcomings of each of the models. Chapter 11 on inflation, unemployment and the Phillips curve attempts an overview of these related fundamental topics within macroeconomics. As such, it is more of a general chapter than many of the others which pick on particular, tighter themes. However, understanding the issues here is fundamental to understanding the study of macroeconomics. New developments and their implications are considered wherever they are relevant. Chapter 12 on economic and monetary union looks at general theory in this area to try to clarify the issues. In particular, an understanding of optimal currency areas is important. Public choice theory is hardly dealt with in the standard textbooks, but it is an important area of economic theory and helps to understand the issues behind political business cycles and independent central banks. Chapter 13 investigates this. finally, Chapter 14 on economic growth suggests that a greater prominence should be given to this area of economic theory in textbooks and explains important recent theoretical developments in this area.