

# Contents

---

## Part 1 INTRODUCTION 1

---

Chapter 1	THE RULES OF THE GAME	3
	The Economics of Scarcity	4
	Scarcity and Choice for an Individual	
	The Functioning of a Social Economy	16
	Four Trade-offs: Choices Facing Every Social Economy	
	The Choice of Mechanisms: Alternative Economic Systems	23
	What Political Economy Is About	26
	Research Methods: The Use of Theoretical Models	
	Summary	30
	Concepts Introduced	31
	Study Questions	31
Chapter 2	RATIONAL CHOICE AND INDIVIDUAL GAIN	33
	Rational Choice: The Model of “Economic Man”	34
	Individual Supplies and Demands	
	The Notion of Individual Gains	44
	Quantifying the Gain by “Willingness to Pay.” Water versus Diamonds: The “Surplus” Obtained from Consuming.	
	Comparing Individual Welfare by Comparing Opportunities	53
	Summary	55
	Concepts Introduced	56
	Study Questions	56

Chapter 3	ECONOMIC EQUILIBRIUM AND THE THEORY OF SUPPLY AND DEMAND	58
	The Concept of Equilibrium	60
	The Individual in Disequilibrium and Equilibrium	
	Economic Equilibrium in a Society	65
	Games People Play: Coinciding and Opposing Interests	
	The "Market Game": Equilibrium and Disequilibrium of Enterprises	69
	Equilibrium Price: The Classical Case of Supply and Demand	
	Epilogue to Part 1: Some Central Issues in Political Economy	79
	Summary	81
	Concepts Introduced	82
	Study Questions	82
<hr/>		
	Part 2 SIMPLE EXCHANGE: THE "GOTHIC" ECONOMICS OF TWO-PERSON TRANSACTIONS	83
<hr/>		
Chapter 4	THE GAINS FROM COOPERATION	85
	Cooperation in Production: Agglomeration of Identical Resources	86
	The Stage of Increasing Returns. Increasing Returns to Scale.	
	Cooperation in Production with Differing Human Resources	94
	Coordinating Nonlabor Resources. Comparative Advantage. Learning by Doing.	
	Cooperation in Consumption	102
	Summary	104
	Concepts Introduced	105
	Study Questions	105
	Appendix: The Potential for Mutual Gain from Foreign Trade and Investment—The Open Economy	106
Chapter 5	OBSTACLES TO EFFICIENT COOPERATION	112
	Moral and Psychological Barriers to Cooperation	113
	Parables of Greed and Moral Hazard. Fear of Reneging: Parables of Distrust.	
	Bargaining: The Possibility of an Impasse	122
	Summary	128
	Concepts Introduced	129
	Study Questions	129
Chapter 6	IDEAS OF FAIRNESS	130
	The Standard of Equality	131
	The Neo-Egalitarians' Notion of "Fairness."	
	Justice According to Rawls	144
	Justice as Rawlsian "Fairness"	

Utilitarianism: Another View of Economic Justice	149
Summary	150
Concepts Introduced	152
Study Questions	152

---

**Part 3 THE POLITICAL ECONOMY OF MULTILATERAL EXCHANGE:  
THE “BAROQUE” ECONOMY 155**

---

Chapter 7	GAINS FROM MULTILATERAL EXCHANGE: LAW, ORGANIZATION, AND MARKETS	157
	Cost Sharing in the Enforcement of Rights: The Rise of Law	158
	Kinds of Property Rights. Paying for Law Enforcement by Compulsory Contribution.	
	Cost Sharing in Management: The Rise of Organization	165
	Information Sharing in Exchange: The Rise of the Market	170
	The Sources of Multilateral Trade	
	A Riddle of Economic History	179
	Summary	180
	Concepts Introduced	181
	Study Questions	181
Chapter 8	PROBLEMS OF PUBLIC CHOICE	182
	Politics as Usual: Obstacles to Efficient Social Choice	185
	Power Politics: Ruling over Pressure Groups	
	Democratic Methods: Majority Rule	191
	The Swing Vote of the Middle Voter. Special Interest Voting by “Single Issue” Voters.	
	Legislating by Majority Rule	196
	Summary	202
	Concepts Introduced	204
	Study Questions	204
	Appendix: Trade Restrictions and “Rent Seeking” in an Open Economy	205
Chapter 9	JUSTIFYING COLLECTIVE ACTIONS: PROPOSED CONSTITUTIONAL PRINCIPLES	209
	Hobbes and Cost-Benefit Analysis	212
	A Unanimity Principle: The “Scandinavian Consensus”	215
	Economic Justice among the Several	224
	Contractarianism: Behind the “Veil of Ignorance”	
	Summary	230
	Concepts Introduced	231
	Study Questions	231

---

**Part 4 CLASSICAL MARKET THEORY AND ECONOMIC POLICY 233**


---

Chapter 10	THE CLASSICAL MODEL OF PURE COMPETITION	235
	How Markets Work: The Neoclassical Theory	236
	Pure Competition	
	Efficiency in Production: The Classical Claim	241
	Production Efficiency within an Industry. Production Efficiency between Any Two Industries.	
	Efficiency in Consumption: The Classical Claim	251
	Comments and Cautions	254
	Summary	255
	Concepts Introduced	257
	Study Questions	257
Chapter 11	MARKET INTERFERENCES BY THE GOVERNMENT: THE CLASSICAL OBJECTIONS	258
	Price Floors: Minimum Wages and Price Supports	259
	The Minimum Wage. Price Supports.	
	Price Ceilings: Maximum Prices and Rationing	267
	Maximum Rentals. Supply Intervention: Public Housing.	
	Rations and Allotments	272
	Rationing Consumers	
	Review and Comments	277
	Summary	278
	Concepts Introduced	280
	Study Questions	280
Chapter 12	MONOPOLY POWER: THE CLASSICAL OBJECTIONS	282
	The Nature of Monopoly Power	283
	The Conditions for Monopoly Power	285
	Legal Barriers to Entry: Public Sanctions and Private Threats. Another Barrier to Entry: Cornering a Resource. Natural Monopoly. Innovation.	
	Monopoly Power: The Effects and Resulting Inefficiencies	294
	The Exercise of Monopoly Power over Output and Price. The Exercise of Monopoly Power over Wage Rate and Employment.	
	Summary	309
	Concepts Introduced	310
	Study Questions	311
Chapter 13	TAXATION AND PUBLIC EXPENDITURE: THE CLASSICAL VISION	312
	Raising Government Revenue	313

---

Graduated Taxation versus the Dreaded Lump Sum. Averting Inefficient Designs of the Tax Structure: “Trickle Down” Theory.	
The Allocative Role of the Classical State	332
Epilogue to Part 4: The Classical Vision of the “Rationalist” State	339
Night Thoughts of the Neoclassical Theoretician	
Summary	342
Concepts Introduced	344
Study Questions	344
Appendix: The Classical Policy Doctrine on Foreign Trade and Investment	345

---

**Part 5 ROMANTIC REBELLIONS 349**

---

Chapter 14	AGAINST THE MARKET: CRITIQUES AND COUNTERSYSTEMS BY MARX AND THE “NEW LEFT”	351
	Those “Dark Satanic Mills”: The Early Hostility to the Industrial Revolution	352
	Marx on Capitalism and Communism	354
	Marx’s Opposition to Return on Capital—and Its Neoclassical Defense.	
	Marx’s Opposition to Commercialism and Markets. Marx’s View of Communism and the “New Man.” The Main Criticisms of the Marxist System. Market Socialism.	
	The New Left	368
	Beyond the “Left”	373
	Summary	373
	Concepts Introduced	375
	Study Questions	375

---

**Part 6 MODERN MARKET EQUILIBRIUM THEORY 377**

---

Chapter 15	PRODUCT MARKETS AND THE FIRM: PRICING AND PRODUCT QUALITY	379
	The Firm: Its Pricing and Customer Share	381
	Customer Markets	
	“Unsafe at Any Price”: The Problem of Product Quality	392
	The Customer-Market View. The Regulation Controversy.	
	Pricing to Signal Quality in Customer Markets	396
	The “Contract” between Firm and Customer	398
	Nonvariable Pricing Viewed as an Insurance Contract. The Distrust of Variable-Price Contracts.	

True Costs and Benefits from Inflation	588
The Difficulty of Reducing Inflation	594
Epilogue to Part 7	594
Summary	596
Concepts Introduced	598
Study Questions	598