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PRICE THEORY

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REVISED EDITION

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CONTENTS

<i>Preface to the Revised Edition</i>	xi
<i>Preface to the First Edition</i>	xiv
1 <i>Preferences and Consumer Equilibrium</i>	1
1.0 The Household and the Consumer	1
1.1 Preference and Indifference	2
1.2 Commodity Space	5
1.3 General Axioms of Choice	7
1.4 Deriving the Indifference Map of a Consumer	9
1.5 A Digression: Lexicographic Orderings	12
1.6 Convex Preferences	14
1.7 Some Properties of Indifference Curves	17
1.8 The Consumer's Budget Set	19
1.9 Consumer Equilibrium	20
1.10 Some 'Pathological' Cases	21
1.11 The Utility Function	28
2 <i>Demand Functions</i>	31
2.0 Income–Consumption Relationship	31
2.1 Income Elasticity of Demand	34
2.2 Price–Consumption Relationship	36
2.3 The Demand Curve	38
2.4 Price Elasticity of Demand	42
2.5 Price Elasticity and Total Revenue	44
2.6 Income and Substitution Effects	46
(a) The Hicks Approach	47
(b) The Slutsky Approach	49
2.7 Redefining 'Normal', 'Inferior' and 'Giffen' Goods	51

2.8	On Various Demand Curves	52
2.9	Substitutes and Complements	56
2.10	Revealed Preference	58
2.11	Some 'Pathological' Demand Curves	62
2.12	Market Demand	65
2.13	Market Demand: Aggregation Problems	66
3	<i>Short-Run Sales Plan of the Firm: The Production Function</i>	70
3.0	Purchase and Sales Plans	70
3.1	Firms' Objectives	71
3.2	Planning Periods	72
3.3	The Production Function: Linear Case	73
3.4	The Production Function: Smooth Case	79
3.5	The Convexity of Isoproduct Curves	80
3.6	The Law of Non-Proportional Returns	82
3.7	Linearity and Product Curves	86
4	<i>Short-Run Sales Plan of the Firm: Cost Functions and Equilibrium</i>	88
4.0	Cost Minimisation	88
4.1	Changes in Relative Input Prices	89
4.2	Cost Functions	92
4.3	Output and Substitution Effects	97
4.4	Equilibrium of the Firm	99
4.5	The Response of Sales Plans to Changes in Product Price	104
4.6	Market Supply	105
4.7	Price-Elasticity of Supply	106
4.8	Changes in Supply	107
5	<i>Long-Run Sales Plan of the Firm: Production, Cost and Supply Functions</i>	109
5.0	The Long Run	109
5.1	Returns to Scale	110
5.2	The Cobb–Douglas Production Function	112
5.3	Indivisibilities	113
5.4	Long-Run Production Possibilities	114
5.5	Long-Run Costs	116
5.6	Choice of a Sales Plan	118

5.7	The Intermediate Period	119
5.8	The Multiproduct Firm	121
6	<i>The Determination of Relative Product Prices</i>	123
6.0	Supply and Demand	123
6.1	Price Determination: Short-Run	124
6.2	Short-Run Price Determination: A Simple Algebraic Approach	130
6.3	Short-Run Demand and Supply Analysis: Applications to Price Control and Taxation	132
6.4	Price Determination: Long-Run	139
6.5	Long-Run Demand and Supply Analysis: Applications	144
6.6	Long-Run Supply: Changing Input Prices	148
6.7	Short-Run and Long-Run Demand	150
7	<i>The Purchase Plan of the Firm</i>	154
7.0	Introduction	154
7.1	Short-Run Demand for One Variable Input	154
7.2	Input Price-Elasticity	158
7.3	The Effects of Parameter Changes	159
7.4	The Short-Run Demand Curve: Two Variable Inputs	160
7.5	The Long-Run Demand Curve	164
7.6	The Total Demand Curve for an Input	165
7.7	The Firm's Demand for a Durable Good	168
8	<i>The Sales Plan of the Consumer: The Supply of Effort</i>	172
8.0	Consumption Time and Work Time	172
8.1	Optimal Allocation of Time	173
8.2	The Supply Curve of Labour	175
8.3	Income and Substitution Effects	178
8.4	The Effort-Demand for Labour	180
8.5	Long-Run Supply	183
8.6	The Sales Plan for the Services of Land	186
9	<i>The Sales Plan of the Consumer: Saving and Savings</i>	188
9.0	The Saving Plan	188
9.1	The Savings Plan: Money and Bonds	204
9.2	The Savings Plan: Wider Portfolio Choice	209

10	<i>The Determination of Relative Input Prices</i>	216
10.0	Relative Wage-Rates	216
10.1	The Determination of the Relative Price of a Durable Good	222
10.2	The Pricing of the Services of Durable Goods	224
10.3	Classifying Inputs: A Note on Human Capital	226
10.4	A Note on Differences in Efficiency between Units of the 'Same' Input	228
10.5	A Note on 'Economic Rent'	230
10.6	The Rate of Interest	233
11	<i>The Determination of Relative Prices: General Equilibrium</i>	246
11.0	General and Partial Analysis	246
11.1	The General Consequences of an Economic Event	248
11.2	The Uses of General Analysis	249
11.3	A Formal Approach to General Equilibrium	251
11.4	The Existence of General Equilibrium Prices	254
11.5	The Stability of General Equilibrium Prices	256
12	<i>Market Behaviour and Market Morphology</i>	259
12.0	The Methodology of Market Models	259
12.1	Pure Competition	261
12.2	Perfect Competition	264
12.3	A Classification of Markets	272
13	<i>Monopoly</i>	276
13.0	The Nature of Monopoly	276
13.1	The Equilibrium of the Monopolist	276
13.2	The Objectives of the Monopolist	280
13.3	Monopolistic Price Discrimination	282
13.4	Advertising	285
13.5	Potential New Entrants	287
13.6	Long-Run Decreasing Costs	289
13.7	Genesis of Monopoly and Maintenance of Monopoly	290
14	<i>Monopolistic Competition</i>	294
14.0	The Nature of Monopolistic Competition	294

Contents

ix

14.1	Short-Run Equilibrium under Monopolistic Competition	295
14.2	Long-Run Equilibrium under Monopolistic Competition	296
14.3	Full-Cost or Average-Cost Pricing	298
15	<i>Monopsony and Monopsonistic Competition</i>	302
15.0	Monopsonistic Markets	302
15.1	Equilibrium under Monopsony	303
16	<i>Oligopoly</i>	307
16.0	The Nature of Oligopoly	307
16.1	The Cournot Model	308
16.2	Leadership Models	316
16.3	The Kinked Oligopoly Demand Curve	325
16.4	Collusive Oligopoly	329
16.5	Game Theory and Oligopoly	339
17	<i>Bilateral Monopoly</i>	344
17.0	Price-Taker Context	344
17.1	Price-Maker Context	347
18	<i>Normative Price Theory</i>	354
18.0	Introduction	354
18.1	Consumer's Surplus: The Concept	355
18.2	Consumer's Surplus: The Marshallian Approach	356
18.3	Hicks's Four Measures of Consumer's Surplus	362
18.4	Compensation Tests	368
18.5	Pareto Optimal Allocations	371
18.6	The Optimality of Perfect Competition	376
18.7	The Problem of Second Best	378
18.8	Public Goods	381
18.9	External Effects	385
	<i>Index</i>	389

PREFACE TO THE REVISED EDITION

In the preface to the first edition of *Price Theory* (1958) Professor Ryan remarked that he had used 'only the traditional tools of analysis', and that 'were this book being written five or ten years later the emphasis given to the various tools would have to be completely reversed'. Fifteen years later the tools of analysis have certainly changed as far as the professional economist is concerned. Linear and non-linear programming, game theory, linear algebra and the traditional weapons of the calculus now play a very much larger role in research and in teaching than they did some years ago. The modern university and polytechnic student is expected to accommodate at least some of these techniques, but it seems right to say that the average student is still largely non-numerate and is likely to remain so for some time, although standards are clearly rising. The modern author does therefore have a choice. He can write for the numerate and reach only a small proportion of the student audience, perhaps hoping that the increasing preponderance of numerate textbooks will give the non-numerate more incentive to learn some mathematics. Or he can write for the non-numerate, gain the larger audience, but at the cost of some rigour, some elegance and the omission of topics which can best be treated mathematically.

I have, in this revised edition of Professor Ryan's justly famous work, tried to steer a middle path. What I have done is to use *some* mathematical *language* in the belief that the biggest obstacle to learning numerate economics is the jargon and not the mathematical manipulation of equations. What I have not done, except occasionally – and only then where a non-mathematical approach has also been used – is to *operate* with mathematics. In this way I hope the reader will gain some of the flavour of modern approaches without being faced with the impenetrable barrier of mathematical limitation.

The actual process of revising the first edition turned out to be far

more complex than I imagined. Both Professor Ryan and the publishers merit my apologies and indebtedness for being so patient with me. The problem lay in the fact that Professor Ryan's original treatment was almost 100 per cent self-contained. It had a logical sequence which, though I strived not to, I fear I have broken. On the other hand, it was difficult to see how *any* change from the original edition could preserve the unique features of that edition. The only real loose ends in the original edition were contained in Chapter 12 entitled 'Some Further Problems'. The topics in that chapter are now integrated in the main body of the text.

In making other changes I have been deliberately subjective and there is no question that I shall be criticised for having included some things, elaborated on others, and omitted still others. The biggest issue was whether to include a substantial section on 'new' theories of the firm. Had I done this the book would have been longer than it is now, and my feeling was that (a) it would have departed even further from Professor Ryan's original aims, and (b) it would have been redundant in face of some excellent recent volumes which have concentrated on this issue. In consequence, the main changes have been to introduce linearity into the chapters on consumer theory and on cost and production theory; to extend the general equilibrium chapter; to 'update' chapters where I have felt this expedient; and to add a new chapter on the normative uses of price theory – that is, welfare economics. While this is a small list, the result has been a substantial change, although I have done little to change Professor Ryan's meticulous treatment of firm equilibrium under various market forms. The chapters have also been rearranged slightly, although here again it was Professor Ryan's careful juxtaposition of chapters in logical sequence that was a dominant feature of the original edition. I can only hope that some of the logical rigour and value of Professor Ryan's original approach, which I cannot hope to emulate, remains.

Lastly, I have written for the market, and this has sometimes meant that I have taken a fairly neutral approach to issues on which I have, in fact, the most decided opinions. In particular I have recorded the conventional approach to the 'efficiency' of market systems, although reference to some of my other work will show that I find this notion of efficiency very unattractive. There is nothing novel in the content of the revised edition: it has all been said before. I can only hope that the arrangement of the material and the exposition will appeal. My debts are therefore fairly obvious and include all writers on economic issues.

A special debt is owed to Christopher Nash of Southampton University who read many of the new sections and commented in his usual invaluable way. And, of course, I owe an immense debt to Professor Ryan for his assistance and advice during the preparation of this manuscript. As always, my greatest debt is to my family. None of these people, least of all my family, bear any responsibility for the errors which no doubt remain.

D. W. P.

University of Leicester

April 1976

PREFACE TO THE FIRST EDITION

It is tempting to begin by defining the scope of economics and describing the methods by which economic truths are customarily pursued in academic circles. The temptation is acute for an economist, for the fascination of economics with its own scope and method verges on neurosis. It is with reluctance, therefore, that we do not deal with these topics explicitly. We shall not prejudice their importance, however, if we define economics as the kinds of thing that economists habitually talk about, and its methodology as the way in which they customarily do so.

Economists generally describe certain decisions that are taken by individuals who are acting on their own behalf, or as agents, in a free society, and attempt to explore some of their effects. The kinds of decision that interest economists are those which lead to a purchase or to a sale. In the Western world, those who decide to buy and sell may be classified roughly into households, firms and the various agencies of government. Each household decides what commodities and services to buy and when, where and in what quantities to buy them. These decisions make up the *purchase plan* of the household. Each household will also have a *sales plan* setting out the things that its members have decided to sell and the quantities, prices and places at which they will be sold. The sales and purchase plans of the household will be related to one another, for the sums of money that the members of the household get from selling their labour or lending their savings or renting their land generally constitute the fund out of which they buy the goods and services of everyday consumption.

Similarly, each firm in the economy must decide what goods to produce and sell and when, where and the quantities in which to sell them. All these decisions make up the *sales plan* of the firm. In addition, each firm must decide what things to use in making its products, and

when, where, how, and in what quantities to use them. All decisions of this kind are summarised in its *purchase plan*.

The purchase and sales plans of the firms are not independent of one another, for firms buy in order to sell. The sums of money that they earn by selling the goods they produce are used directly or indirectly to pay for the things they require to assist in their production and sale. We would expect, too, some relation between the plans of households and those of firms. The things that firms plan to sell must be similar to those which households plan to buy, and the things that firms plan to buy must be more or less the same as the things that households or other firms are planning to sell.

In a free world the implementation and revision of these plans affect almost all facets of human life and endeavour. As economists, however, we are primarily interested in how these plans determine both relative prices and price levels. As firms and households act on the plans they have made, the relationship between prices may alter: butter may become more expensive than nails or bread less dear as compared with jam. And almost all prices might rise as they have done since 1939, or fall as they did in the early 1930's. These twin effects are inextricably and indistinguishably linked together, but if we are to grasp their nature we must examine each in isolation. In this book we are primarily concerned with the determination of the relationship between the prices of the things that are bought and sold.

This book is intended as a text-book for students who are planning to specialise in economics. I have tried to state all the assumptions explicitly and to keep the analysis rigorous. The analysis may occasionally seem to be a trifle self-conscious, for I believe that it is important for students to learn not only what economists do but why and how they do it. There are frequent summaries of the analyses, and I hope that these will be more helpful than they are tedious. I do not think that there is anything that is original in the contents of this book, but there may be some originality in the form in which they are presented.

In elaborating the theory of relative prices, I have used only the traditional tools of analysis. While these tools are suffering a rapid obsolescence, they still do a better job than the prototypes of the tools which may soon supplant them and which are briefly described in the final chapter. It is not improbable, however, that were this book being written five or ten years later, the emphasis given to the various tools would have to be completely reversed.

I am deeply indebted, either directly or indirectly, to all economists who have written on the theory of price. If I make no attempt to acknowledge my debts in detail, it is because they are too numerous and because I have forgotten the transactions in which many of them originated. I wish to express my gratitude to Professor G. A. Duncan, Professor A. T. Peacock, Professor G. L. S. Shackle, Dr. A. W. H. Phillips, Mr. Jack Wiseman and Mr. F. P. R. Brechling who read the manuscript and made many valuable suggestions and criticisms, and to the students in the London School of Economics and Political Science and in the University of Dublin who forced me to strive after clarity both in thought and expression.

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