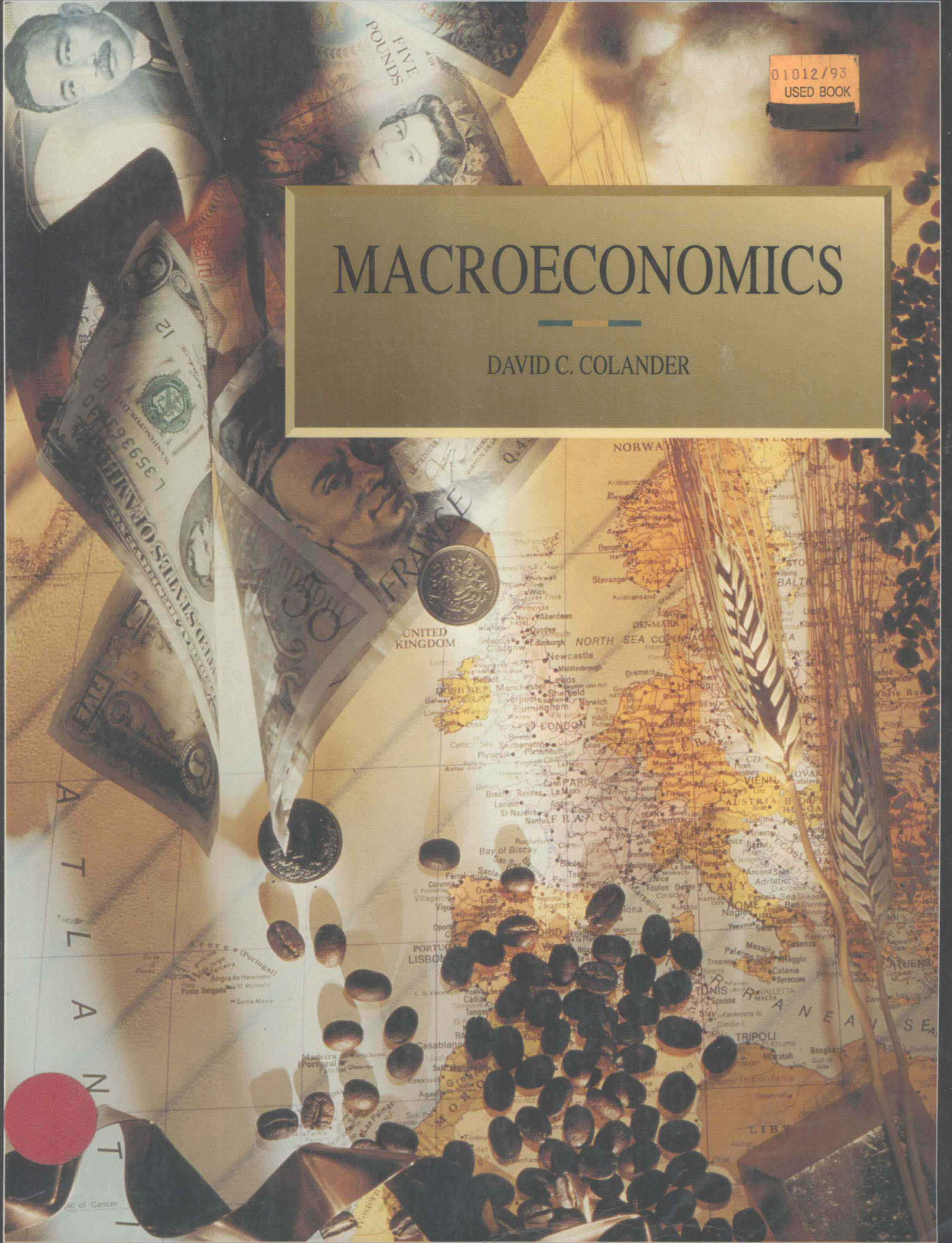


01012/93
USED BOOK

MACROECONOMICS

DAVID C. COLANDER



MACROECONOMICS

DAVID C. COLANDER
Middlebury College



IRWIN

Homewood, IL 60430
Boston, MA 02116

Section opener photos

Section 1 Reuters/Bettmann

Section 2 Tony Savino/The Image Works

Section 3 Reuters/Bettmann

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Senior sponsoring editor: Gary Nelson

Developmental editor: Pat McCabe

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Production manager: Irene H. Sotiroff

Designer: Laurie J. Entringer

Art manager: Kim Meriwether

Photo research coordinator: Patricia A. Seefelt

Compositor: Better Graphics, Inc.

Typeface: 10/12 Times Roman

Printer: Von Hoffmann Press

Library of Congress Cataloging-in-Publication Data

Colander, David C.

Macroeconomics / David C. Colander.

p. cm.—(The Irwin series in economics)

Includes index.

ISBN 0-256-11303-3

1. Macroeconomics. I. Title. II. Series.

HB172.5.C638 1993

339—dc20

92-30748

Cover photo: Hans Neleman, The Image Bank

Printed in the United States of America

1 2 3 4 5 6 7 8 9 0 VH 9 8 7 6 5 4 3 2

*To Bill Vickrey,
whose integrity, honesty, brilliance, and eccentricities
make me proud to have been his student*

Preface

Why write a new introductory economics textbook? Since I am an economist, the answer must be that the expected benefits outweighed the expected costs. But that doesn't mean I had my bank balance in mind when I decided to write this book. Quite honestly, there are easier ways of earning money (my wife's a doctor). There had to be some other benefits out there. For me, those other benefits had to do with a belief about how economics should be taught—what was important and what was not.

Before I started writing this book I had done quite a bit of research on economic education. As part of that research Arjo Klamer and I had surveyed and interviewed graduate students in a number of top graduate programs. Two of the most disturbing things we discovered were that economic institutions and economic literature were being given short shrift in graduate economics education. For example, in response to the question, "How important is a knowledge of economic institutions to being successful as an economist?" only 10 percent of the students responded that it was very important, while 43 percent said it was unimportant. In response to the question, "How important to achieving success as an economist is having a thorough knowledge of the economy?" only 3 percent said it was very important, while 68 percent said it was unimportant.

I believe that the majority of the profession is concerned with these results. Certainly the students we interviewed were concerned. They said they believed that institutions and literature were very important. Their survey responses simply indicated their perception of how people succeed in the profession, but the current situation was not the way it should be. Almost all economists I know believe that students need to know economic literature and have a thorough knowledge of the institutions. Without the appropriate background knowledge of institutions and literature, all the technical skills in the world aren't going to provide one with the economic sensibility necessary to understand what's going on in the economy or to decide whether or not a model is relevant.

As I thought about these results and considered my own teaching, I realized that the problem was not only in graduate schools; it had filtered down to undergraduate texts. As I looked through the texts, I saw excellent discussions of technical issues and of models, but little discussion of economic sensibility. These books didn't even try to provide the intellectual context within which those models developed or the institutional context to which these models were to be applied. The standard texts had settled into teaching technique for the sake of technique and had shifted away from teaching economic sensibility.

I decided that if I were serious about playing a role in reinstituting economic sensibility and a knowledge of institutions and literature in economic education, I would have to write an introductory textbook that did that. I took it as a challenge. Meeting that challenge was what drove me to write this book; it is what kept me going when all my rational instincts told me it was too much time and too much work.

Teaching Economic Sensibility

The question I faced was: How do you incorporate economic sensibility into a textbook? Economic sensibility is more than a knowledge of modeling techniques; it is a mindset in which one's lens of the world is a latticework of ascending cost/benefit frameworks in which one is deciding on the optimal degree of rationality. Economic sensibility is an enforced reasonableness that provides insight into complicated issues; it is a perspective, not a technique. The argument I heard in favor of teaching technique was that economic sensibility could not be taught. I reject that argument. Economic sensibility may be hard to teach because it does not come naturally for most people, but it can and must be taught. The question is: How do you teach it? The answer I came to is "Enthusiastically."

Economics with Passion

I am first and foremost an economics teacher; I am excited by economics. I find economic ideas relevant, challenging, and exciting. In my lectures I try to convey that excitement, and if the lecture is going right, I can feel the excitement in my students. Then off they go to read the text. All too often when they return to class, the fire in their eyes is gone; the textbook has lulled them into complacency. Those who know me know that I can put up with many things (not quietly, but nonetheless put up with), but one of those things isn't complacency. I want students to think, to argue, to challenge, to get passionate about the ideas. I encourage this reaction from students not just because economists' ideas deserve to be treated passionately, but also because, through a combination of passion and reason, eventually students achieve economic sensibility. I decided what was missing from most textbooks was the passion. I promised myself my book would retain the passion.

Now there's no way I'm going to get passionate about Slutsky equations, phase diagrams, indifference curves, or an AS/AD model. Mathematicians may get passionate about such things, I don't. I do get passionate about the insights economics gives one into the problems we, as individuals

and as society, must face: the budget deficit, TANSTAAFL, environment, and agricultural subsidies. If the techniques help in understanding the ideas fine, but if they don't, good-bye to the techniques.

Passion without Bias

While not all textbooks are written by passionless people, the conventional wisdom is that authors should hide their passion to make their books more marketable. In some ways this makes sense—often passion and ideological bias go together. Many economists' passions are ideologically linked, and if you remove the ideology, you remove the passion. Good economic sensibility cannot be—and cannot even appear to be—biased; if passion is purged in maintaining neutrality, it is purged for a good cause.

But passion and ideological bias need not go together. I believe it is possible for a passionate textbook to be reasonably objective and unbiased. And I set out to write a book that would be as unbiased as possible (but not more so) and to do so without masking my passion for economic ideas. Various techniques allow me to do this. For example, to keep the students interested in the ideas rather than focusing on technique, I present some ideas in a debate format with two passionate believers on both sides arguing the points. The debate format makes the arguments come alive; they are no longer technical issues that must be memorized; they are passionate ideas, and as the students get caught up in the debate, they think about the ideas much more deeply than they otherwise would.

A Conversational Tone

To transmit that sense of passion to the students, I needed a writing style that allowed it to come through. Quite honestly, textbookese douses passion faster than a cold shower. So this book is not written in textbookese. It's written in conversational English—I'm talking to the students. When they read the book, they will know me; they may not like me like my mother likes me, but they will know me.

The conversational tone is not a monotone; it ebbs and flows depending on the nature of the material. Sometimes, in the analytic parts, the style approaches textbookese; the important technical aspects of economics requires technical writing. When we hit those parts, I tell the students and encourage them to stick with me. But, even here I try to provide intuitive explanations that students can relate to.

The use of conversational style has two effects. First, it eliminates the sense some students have that textbooks provide the "truth." When the textbook author is a real person with peccadilloes and warts, the students won't accept what he or she says unless it makes sense to them. Approaching a textbook with a Missouri "show me" attitude stimulates true learning. Second, the conversational style keeps the students awake. If students' heads are nodding as they read a chapter, they're not learning. Now I know this book is not *Catcher in the Rye*; it's a textbook conveying sometimes complex ideas. But the excitement about economic ideas and the real world comes through.

The approach I take allows me to deal simply with complicated ideas. For example, in the book I discuss New Keynesian economics, New Classical economics, and real

business cycles. The conversational style conveys the essence of these complex topics to students in a nontechnical fashion without tying the students' brains up in technical tourniquets. The style allows me to relate the ideas to concrete examples, rather than mathematical formulas, providing intuitive discussions of the ideas that capture the economic sensibility.

Models in Historical and Institutional Context

Discussing only the minimum of techniques necessary for the students to understand the ideas allows me more leeway to get into, and discuss, institutional and historical issues as they relate to current policy. Models without context are meaningless, and thus you'll find more historical and institutional issues in this book than in other principles books. The book has numerous maps; the discussion conveys the sense that geography, history, and psychology are important, even though it touches on them only tangentially.

One of the ways in which this historical and institutional approach shows up is in the complete coverage of the changing nature of economic systems. Socialism is undergoing enormous changes, and students are interested in what is happening and why it is happening. Their questions cannot be answered with technical models, but they can be discussed informally in a historical context. And that's what this book does.

International Focus

When I started to work on the book back in the 1980s, I decided to include a much deeper discussion of the international sectors than most textbooks did then. Now, while most books at least purport to have international coverage, this book definitely does.

In the introductory section, a full chapter, "An Introduction to the World Economy," sets the stage for the integration of international issues into the text (no other principles book has such a chapter). In the macro section, not only are international issues built into the macro model from the get-go; but an entire chapter, "The International Dimensions of Monetary and Fiscal Policies," places macro policy in an international perspective. Additionally, in the case study chapter, "Macroeconomics, Social Policy, and Economic Reasoning," international issues once again come to the fore. And a full four chapters are devoted to international issues at the end of the book, providing the flexibility for professors to give even more emphasis to international issues, depending on time constraints.

The Invisible Forces

I've incorporated in the book a pedagogical device I've found useful where I want to include the social and political forces that affect reality. That device is to convey to students a picture of reality being controlled not only by the invisible hand, but also by the invisible foot (politics) and the invisible handshake (social and cultural forces). This *invisible forces* imagery lets me relate economists' abstract models to the real world; it allows me to discuss the real-world interface between economics, politics, and social forces. What makes this device effective is that students can picture these three invisible forces fighting each other to direct real-

world events; that image allows them to put economic models into perspective.

Other Pedagogical Features

I hope you'll find the style and approach teachable. But a textbook needs more than style to be user-friendly, and the publisher and I have worked hard to make this the most user-friendly textbook that exists. Let's consider the in-text pedagogy.

Overall Organization

The book is divided into three sections, and the macro section is divided into subparts. This organizational structure allows the instructor to pick and choose materials for the course, whether it be for an 8-week quarter or a 16-week semester. A number of alternative outlines are presented in the Instructor's Manual to assist you in using this book effectively.

Learning Objectives

Each chapter opens with a numbered list of learning objectives. These objectives give students a sense of the chapter concepts and provide a guide to approaching the material. The numbers associated with each objective are keyed to the text discussion, allowing students to focus on the discussion with a context. The learning objective numbers are also integrated with the key points in the chapter summaries. Thus, the learning objectives provide a framework both for learning and for review.

Key Terms

The vocabulary essential to understanding economics is boldfaced within the running text at the point where the term is introduced and defined.

Marginal Definitions

The key terms are used to form a running glossary for each chapter. The boldfaced term is highlighted and again defined in the margin, permitting easy review of important terminology and concepts. (Boldfaced page numbers in the index allow for quick reference to the marginal definitions.)

Graphics

Analytical graphs are simple and straightforward so that students can easily follow what's happening. Consistent use of color allows differentiation between movements along curves and shifts of curves. Descriptive and historical data are presented in a visually attractive fashion that parallels what the students will see in the popular press. Periodic photos direct the students outside the text and into the real world. For example, almost every chapter has a margin picture of a reference source, letting students know that there's much more to economics than what's in the text.

Boxes

The text discussion is further enlivened, both visually and conceptually, by a series of boxes. These boxes serve one of

two purposes. Those entitled "A Reminder" serve as a review for students; they summarize and consolidate key material. Those entitled "Added Dimension" either extend the text material or provide another perspective on it, relating the material to the real world and deepening students' understanding.

Case Studies

Economics is more than textbook discussions of models. It is applying economic reasoning to economic events, using economic knowledge to interpret articles about economics, understanding when economic reasoning is being objectively applied and when it is biased. It is a type of critical thinking, involving the use of models not because they are right, but because they are useful.

To apply economics effectively, students must have practice in doing so. For that reason this book differs from other books: it includes case studies and newspaper articles as integral parts of the text. It then discusses both the content and the perspective of those articles, giving the students some practice in going beyond the text and actually applying what they learn. One chapter, "Macroeconomics, Social Policy, and Economic Reasoning," is devoted entirely to these case studies.

Chapter Summaries and Key Terms List

At the end of each chapter are both a chapter summary and a key terms list. The summaries provide a review of the key points; they reflect the integrated learning strategy that organizes the pedagogical presentation of the material. Each of these points is referenced to the appropriate learning objective, making review more efficient. The page-referenced key terms list provides quick review of the terms that have been boldfaced in the text and that all students should know.

Questions for Thought and Review and Problems and Exercises

Each chapter concludes with 10 questions and 2 problems or exercises. These take the students back through the chapter. Some ask for recall, some ask the student to apply reasoning, some ask for synthesis of the material, and some ask the student to go beyond what they have learned and apply not the analysis, but the general economic reasoning process they have learned. Each question is rated for degree of difficulty. To further stimulate the students to go beyond the text, some questions send students into the library or to real world institutions for answers.

Appendixes

Appendixes that lead the students beyond the chapter material are found at the end of various chapters. These cover issues such as graphical analysis, and the mathematics of the Keynesian model. They allow a deeper technical presentation by those faculty who want it.

Pedagogical Supplements

The supplements package that supports the text received the same careful attention to pedagogy as did the text.

The **STUDY GUIDE** enables students to review chapter content and key concepts through a variety of exercises that are integrated by the pedagogical framework of the text. Students are encouraged to practice analyzing, evaluating, and using economic information with two special types of exercises. And multiple-choice mastery tests provide practice for classroom exams. Answers are included for all activities.

The **INSTRUCTOR'S MANUAL** uses P.L.U.S. (*Professional Learning Unit Systems*) to identify which of the text and ancillary learning aids are available to students and instructors within a lecture outline, providing an at-a-glance menu. The lecture outline for each chapter also suggests points to emphasize, further topics for discussion, in-class exercises, and it identifies critical thinking skills. A separate section provides alternative examples and offers suggestions for drawing on other critical thinking skills, based on the chapter material. Annotated selected readings and references and a bibliography of supplementary resources round out the resources offered in this ancillary. Answers to end-of-chapter questions are provided.

The **TEST BANK** offers approximately 100 questions per chapter that are classified by learning objective, degree of difficulty, and skill. Where useful, questions contain a rationale for their answers. (Software versions on Computest3 are available.)

TEACHING TRANSPARENCIES are available for all of the important figures and tables in the text.

READY NOTES replicate, in book form, the *Teaching Transparencies* so that students may take notes and make sketches easily during lecture.

PRINCIPLES OF ECONOMICS SIMULATION SOFTWARE allows students to apply the economic theory they are learning by making decisions in a variety of economic contexts and seeing the effects of those decisions. A workbook asks students to make observations, answer questions, and complete exercises as they work through the simulations. Available for IBM or IBM-compatible PCs.

MACROVIEW is a tutorial that uses modules, with page references to the text, to help students explore key macroeconomic concepts. Students are directed to manipulate graphical or other information in a model and then to answer questions about the effects of these actions on various relationships. The software is available for IBM or IBM-compatible PCs.

COMPUTEST3 TEST GENERATOR allows instructors to add and edit questions; save and reload tests; create different versions of each test; attach graphics to questions and/or answers; import and export ASCII files; and select questions based on type, level of difficulty, key word, learning objective or skill level. Included on the disk is an Online Testing Program that allows the testmaker to create tests that can be taken by students using a computer. Computest3 provides password protection of saved tests and the question database and it can run on a network. Available for IBM and IBM-compatible PCs.

ECONOMICS NEWSLETTER, which examines current U.S. and world economic issues and is published periodically by Richard D. Irwin, is sent to adopters.

ECONOMICS U\$A, the video library, is also available to adopters. These 28 half-hour programs bring economic theory to life with a blend of historic footage, documentary sequences, interviews, and analysis.

People to Thank

A book this size is not the work of a single person, despite the fact that only one is listed as author. So many people have contributed so much to this book it is hard to know where to begin thanking them.

The initial push for the project came from a friend, Scot Stratford. He knows how important he was for this book coming into being, and I thank him. Then there were those who worked on the early drafts: Viraj Miranni, Steve Fossil, Cele Gardner, Jim Elia, and numerous other students, colleagues, and friends who worked on aspects of the book along the way. Various classes suffered through early versions of the text and told me what worked and what didn't. The book was written for them, and it could not have been written without them.

Throughout the entire process there were the numerable referees who went through the drafts and kept me on track:

Jack Adams <i>University of Arkansas</i>	Phillip Droke <i>Highline Community College</i>
Stan Antoniotti <i>Bridgewater State College</i>	Fred Englander <i>Fairleigh Dickinson University</i>
Mahmoud P. Arya <i>Edison Community College</i>	Val Englander <i>Fairleigh Dickinson University</i>
James Q. Aylsworth <i>Lakeland Community College</i>	Sharon Erenberg <i>Eastern Michigan University</i>
George Bohler <i>University of North Florida</i>	Rhona C. Free <i>Eastern Connecticut State University</i>
Bijit K. Bora <i>Carleton College</i>	Joseph Garwood <i>Valencia Community College</i>
Gerald E. Breger <i>Grand Rapids Junior College</i>	Bernard Gauci <i>Hollins College</i>
Gary Burbridge <i>Grand Rapids Junior College</i>	Robert Gentennar <i>Hope College</i>
Mario Cantu <i>Northern Virginia Community College</i>	Jack B. Goddard <i>Northeastern State University</i>
Tom Carroll <i>Central Oregon Community College</i>	Deniek Gondwee <i>Gettysburg College</i>
Carol A. M. Clark <i>Guilford College</i>	Richard Hansen <i>Southeast Missouri State University</i>
Roy Cohn <i>Illinois State University</i>	Raymond N. Harvey <i>Niagara County Community College</i>
Eleanor Craig <i>University of Delaware</i>	Robert Jantzen <i>Iona College</i>
Jerry L. Crawford <i>Arkansas State University</i>	
Ed Dennis <i>Franklin Pierce College</i>	

Walter Johnson <i>University of Missouri</i>	Debbie A. Meyer <i>Brookdale Community College</i>	E. Dale Peterson <i>Late of Mankato State University</i>	Robert Stonebreaker <i>Indiana University of Pennsylvania</i>
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Leonard Lardaro <i>University of Rhode Island</i>	William Morgan <i>University of Wyoming</i>	Linda Schaeffer <i>California State University-Fresno</i>	Wade Thomas <i>State University of New York College at Oneonta</i>
Randall Lutter <i>State University of New York at Buffalo</i>	Mark Morlock <i>California State University-Chico</i>	Ted Scheinman <i>Mt. Hood Community College</i>	Joe Turek <i>Illinois Benedictine College</i>
Raymond Mack <i>Community College of Allegheny County Boyce Campus</i>	H. Richard Moss <i>Ricks College</i>	Timothy Schibik <i>University of Southern Indiana</i>	Alejandro Velez <i>St. Mary's University</i>
Drew Mattson <i>Anoka-Ramsey Community College</i>	Theodore Muzio <i>St. Vincent College</i>	Dorothy Siden <i>Salem State College</i>	David Weinberg <i>Xavier University</i>
Bruce McCrea <i>Lansing Community College</i>	Hillar Neumann, Jr. <i>Northern State University</i>	R. J. Sidwell <i>Eastern Illinois University</i>	Kenneth Woodward <i>Saddleback College</i>
H. Neal McKenzie <i>Dalton College</i>	Maureen O'Brien <i>University of Minnesota-Duluth</i>	G. Anthony Spira <i>University of Tennessee</i>	
	Amar Parai <i>State University of New York College at Fredonia</i>	Mitch Stengel <i>University of Michigan-Dearborn</i>	

I cannot thank this group of referees enough. They corrected many of my stupid mistakes, they explained to me how a text can contribute to good teaching, and they kept me focused on combining teaching economic sensibility with economic models. They provided me with page upon page of detailed comments and suggestions for improvement. The book strongly reflects their input and is much more usable because of that input.

Just before I began the final draft of the manuscript, we took another look at our plans for the book via a questionnaire. Thanks to the over 500 who responded. Those responses helped to confirm many ideas and to fine-tune the final manuscript. When the final draft was finished, it was classroom-tested by R. Asher at Bowie State University and by James Q. Aylsworth at Lakeland Community College and their students. They discovered a few mistakes and offered helpful suggestions and enthusiasm, which I gratefully accepted.

Once the manuscript takes its final form there are still an almost infinite number of jobs to be done on it. Figures must be checked, arguments checked, drafts read, reread, and reread once again. I had immense help in these undertakings: Ding Chun, George Doupsas, and Ali Mehdi worked one whole summer for me, and Chris Gemignani worked another on such projects. They did a great job.

In this entire process the people at Irwin were extremely important and helpful. One was Wendy Hagel, a sales rep at Irwin, who convinced me that Irwin was the right publisher for me. Another was Gary Nelson, the sponsoring editor, who believed in the project and saw to it that it went forward. He, more than anyone else, has kept this project on track. The book would not have been what it is without him. With his steadying influence, he has coordinated the entire process and made it work. Then there's Pat McCabe, my development editor, who had to put up with me through the entire process. She not only did that with great aplomb; she

also added important pedagogical dimensions to the book and maintained her sense of humor and belief in the book throughout a sometimes hectic and stormy process. Then there's the upper-level management at Irwin, specifically, Lew Gossage, Bill Setton, Jeff Sund. I had less contact with them, but I fully recognize their guiding hands. Their belief in the project and their willingness to make it possible for an antibureaucratic author to fit in with a formal publishing institution allowed the book to proceed. I thank them all enormously.

The actual production process of a four-color introductory book is complicated, and to do it on an accelerated schedule requires enormous efforts. Luckily, I had Lynne Basler as project editor directing the manuscript through the process. She did a superb job, as did all the players in the production process: Bruce Sylvester, the copy editor; Laurie Entringer, the designer who made the book look good; Michelle Oberhoffer, the photo researcher; Irene Sotiroff, production manager, who worked with Better Graphics, Inc., the typesetter and Von Hoffmann Press, the printer; and Kim Meriwether, art manager, who worked closely with EletraGraphics, Inc., on the art program.

Of course, as they did their superb job, they created more work for me, reading the galley proofs, the page proofs, and doing all the final checking that must be done in an effort to eliminate those pesky errors that occur out of nowhere. Paul Sommers went over the manuscript with his fine-tooth comb and discerning eye and caught things overlooked until them. I thank him.

After you have what you believe is a good book, the process still isn't done. You still have to get people to look at it. Ron Bloecher, Bevan O'Callaghan and John Wood started early to develop a strategy that will get the book considered. Then, there are the sales reps who are the core of a textbook publishing company. Long before this book was complete I met with many sales reps, discussing the book and learning

to see it through their eyes. That process made the book much better than it otherwise would have been.

These days an introductory economics book is much more than a single book; it is an entire package, and numerous people have worked on the package. Paul Estenson and Mary Acker did the INSTRUCTOR'S MANUAL; Richard Trieff and Benjamin Shlaes did the STUDY GUIDE; and Mitch Charkiewicz, Susan Dadres, Joanne M. Dott, Eleanor R. Fapohunda, Dorinda Lynn, and Thomas A. McGahagan worked on the TEST BANK with me. They did a great job, and I thank them one and all.

Finally, there's the group of people who helped me at every stage of the process. Throughout the entire project,

Helen Reiff has been my right hand temporarily putting aside her law practice to see that justice was done to my book. Then, there's my wife, Pat, who put her medical practice on hold to give me more time to work on the book. She saw to it that Zack and Kasey, both of whom were conceived after this project was underway, and I, got the love and care we needed. My love and admiration for her remain as unbounded as ever.

As you can see, although my name is on the book, many people besides me deserve the credit. I thank them all.

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2 Macroeconomics

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