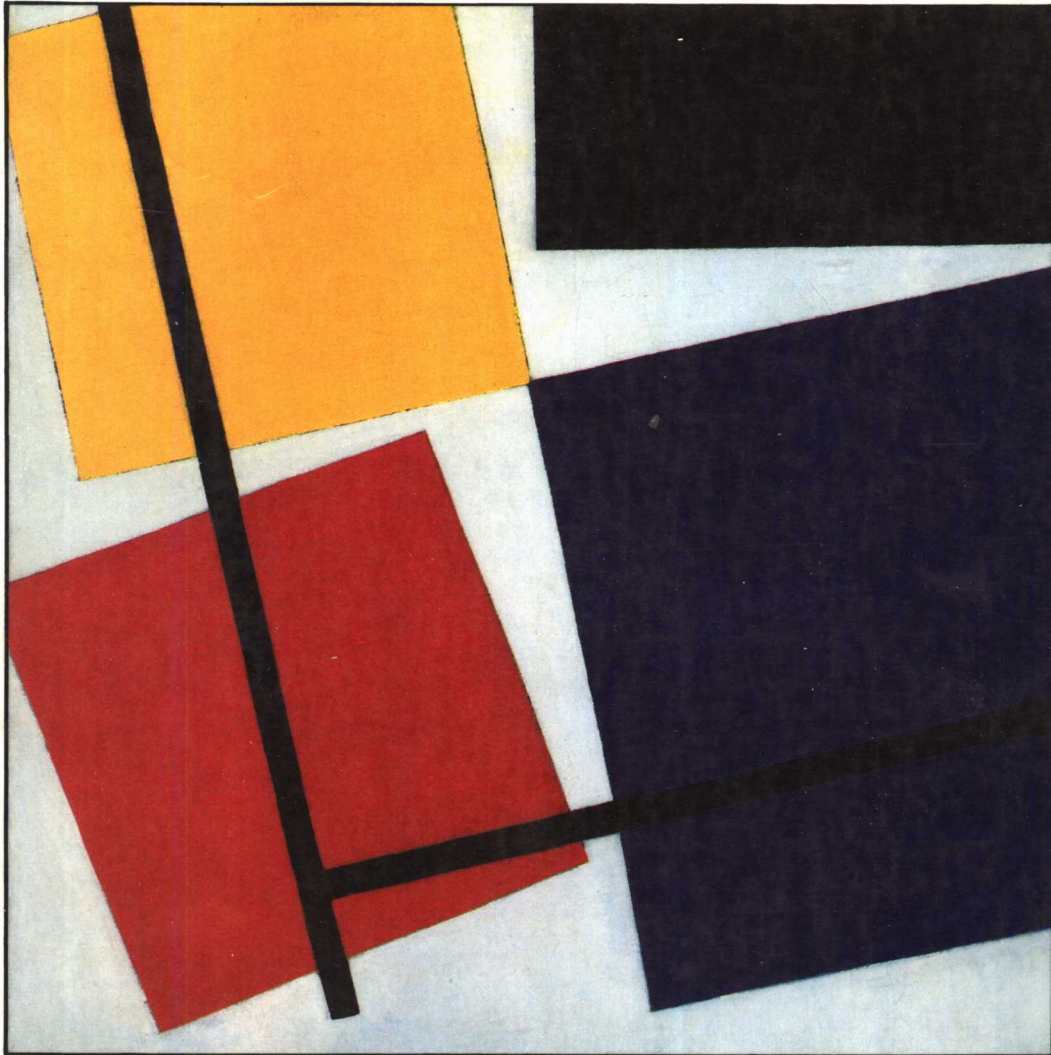


PRINCIPLES OF MACROECONOMICS



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***Principles of
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Principles of Macroeconomics

To Lars and Linda
Sara, Andrea and Katherine
R. T. F.

To Lill
D. F. G.

Prefa

There are a number of good introductory economics textbooks. Our book acknowledges their strengths by emulating them in several respects. First, it shares a common purpose with others. We explain how the economy works when functioning freely by markets, as well as when influenced by government policies. Second, our selection of subjects has not strayed from the mainstream. We treat the standard topics: market equilibrium; the Keynesian, monetarist, and new classical models; monetary and fiscal policy; economic growth; oligopoly and other market structures; income distribution; labor relations; and international monetary relations and international trade. In the paperback volumes we cover the standard topics in clusters of micro and macro orientation, as is now customary.

We explain different political and ideological views in an evenhanded manner. We cover the views of both conservatives and liberals.

Features

Why then another principles text? Why try this new offering? An examination of the book will reveal many distinguishing features—matters of content, organization, and exposition.

One significant feature is *logical flow*. The student should not be left with the impression that economics is a loose collection of unconnected topics. We avoid this in several ways. For example, all principles books refer to the basic questions of “what,” “how,” and “for whom” in the early chapters. We maintain the connection between these basic questions and various aspects of market performance discussed later in the book. In the same vein, we maintain a focus for the student by developing the methodology of two-question logic. For macroeconomics the two questions are “What is expected?” and “What actually happens?”; for microeconomics the questions are “What are the benefits?” and “What are the costs?” Using this two-question logic much hard analysis can be

reduced to familiar ways of thinking. The flow of several chapters is smoothed by the use of a running example. In Chapter 5, for instance, the basic facts of American business are illustrated by a series of discussions concerning General Motors.

A second source of freshness concerns *summaries*. Most texts open each chapter with a preview or outline of the contents and close with a recapitulation. We do this and more. We introduce additional summaries within the chapters. Charts that compare several related diagrams appear throughout the book. “Check your Bearings” reviews within chapters help readers cement their comprehension at intervals shorter than those afforded by end of chapter summaries. Chapter 16 is itself a summary, tying together the classical, Keynesian, monetarist, and new classical models.

A third characteristic, overlapping the others, is *care*. We maintain a sequence of presentation and develop matters one step at a time. We draw a distinction between *problems* to be solved (for example, what price maximizes profit) and *dilemmas* that require value judgments (for example, the short-run unemployment–inflation tradeoff). We develop alternative macroeconomic models in a clear building-block fashion, with rigor, but without excess complexity.

Finally, while as stated above we cover all mainstream topics, we also include many topics of *current interest*. In this macroeconomics volume the reader will find: an up-to-date treatment of controversies between Keynesian and new classical economists; a discussion of monetarism as related to instability in monetary aggregates in the 1980s; thorough coverage of international economic questions such as exchange rate management and instability, strategic considerations in trade policy and the causes and effects of U.S. trade deficits; and analysis of recent shifts in monetary policy strategy and of fiscal policy in the post Gramm-Rudman environment.

Organization

The macroeconomics volume is organized as follows.

PART I is common to both the macroeconomics and microeconomics sections and lays the foundation for the whole volume. Chapter 1 begins with the fundamental concepts of scarcity and choice. In Chapter 2 production possibility frontiers illustrate scarcity in a formal fashion. Opportunity costs naturally follow, and their manipulation leads logically to the development of specialization, market exchange and circular flow. Chapter 3 presents simple market mechanics—demand, supply and their interaction. Chapter 4 covers the market's shortcomings and introduces government as the source of economic policy, recognizing that such intervention may be harmful. Chapter 5 concludes Part I with a glance at basic business realities, such as corporations and stock markets.

PART II begins with a definition and discussion of unemployment and inflation—two key macroeconomic variables—in Chapter 6. Chapter 7 describes the central measures in the National Income Accounts. In Chapter 8 we turn from describing to explaining the behavior of macroeconomic variables. Four macroeconomic models (or systems) are discussed in turn. The starting point is the *Classical* system (Chapter 8). Consideration of the classical system at the start is useful for several reasons. Understanding the classical system provides the background for understanding the *Keynesian revolution*. Moreover, the major modern challenges to Keynesian views are all rooted in classical theory. *Keynesian* economics is presented in Chapters 9–12, building up the complete model in steps. Chapter 13 applies the Keynesian theory to explain the behavior of inflation and unemployment over the past three decades. The next two chapters consider modern alternatives to the Keynesian theory—*monetarism* in Chapter 14 and the *new classical economics* in Chapter 15. Chapter 16 concludes Part II with a summary of the models, examining areas of consensus as well as controversy.

PART III goes into more detail concerning *macroeconomic policy*. Policy questions are discussed in Part II as well, but to keep the initial presentation of macroeconomic models simple, institutional detail and most discussion of actual policy-making procedures are left to Part III. Chapters 17 and 18 consider monetary policy and the banking system. Chapter 19 deals with fiscal policy. In Chapter 20 the focus shifts to the longer run as economic growth and trends in employment and unemployment are discussed. Supply-side economic theories and fiscal policy enter in this discussion, in Chapter 20 as well as Chapter 19.

PART IV begins with an analysis of international economics. Chapter 21 recalls international considerations from our earlier discussion of macroeconomic models and policy questions. In fact, a number of examples used in the earlier analysis help to emphasize that the U.S. economy functions within a world economy. Now in Chapters 21 and 22 international trade and international monetary relations come to center stage. Chapter 23 closes the macroeconomics volume with a discussion of the developing economies and of nonmarket communist systems. The Soviet economy is used as an example of a nonmarket economy and recent Soviet economic reforms are described.

Learning Aids

The book includes a number of features aimed at increasing reader comprehension. These are:

- Chapter outlines at the beginning of each chapter
- "Check Your Bearings" sections for review at crucial points
- Boxed *Perspectives* that expand on the text discussion
- End-of-chapter summaries
- End-of chapter questions
- Lists of key terms following each chapter
- Glossary with definitions of key terms

Teaching Aids and Supplements

Principles of Economics has a complete set of materials containing the following elements:

1. An *Instructor's Manual*, written by Professor Jack Adams of the University of Arkansas—Little Rock, includes chapter objectives and highlights, suggested instructional strategies, research projects, and complete answers to all end-of-chapter questions and problems.

2. A *Study Guide* by Professor Guy Schick of California State University, Fullerton, will provide students with outstanding self-instructional content. It contains appropriate lists of key terms, succinct summaries of chapters, and a variety of self-tests: multiple choice, true-false, and fill in questions. In addition, graphical and numerical problems are included.

3. The *Test Bank* has a mix of multiple choice, fill-in, true-false, and short essay questions. An additional test bank will contain all multiple choice questions.

4. *Transparencies* will be available upon adoption for those instructors who want overhead projections.

5. *Software* will be provided in a simple "menu-driven" program for students that will contain a series of mini-simulations in which students can make a variety of economic decisions.

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With all this help, it is more than normally the case that the authors are at fault for weaknesses or errors that may remain.

R. T. F.
 D. F. G.

Contents

I

Introduction

CHAPTER 1

The Heart and Soul of Economics

3

I. Scarcity and Economics 4

- A. Scarcity
- B. Definition of Economics

II. The Basic Economic Questions Raised by Scarcity 7

- A. What? (Resource Allocation)
- B. How? (Production Techniques)
- C. Who? (Distribution)
- D. What's New? (Technological Change and Growth)
- E. How Stable? (Aggregate Employment and Price Levels)

III. Positive Economics and Normative Economics 8

- A. Positive Economics (Actualities)
- B. Normative Economics (Value Judgments)
- C. Positive and Normative Economics Plus Procedures and Results

IV. Choice Procedures 11

- A. Observed Economy (Positive)
- B. Desired Economy (Normative)

V. Choice Results 13

- A. Observed Economy (Positive)
- B. Desired Economy (Normative)

VI. The Methods of Economists 16

- A. Positive Economic Analysis
- B. Normative Economic Analysis

VII. Common Pitfalls in Economic Analysis	18
A. The Fallacy of False Cause	
B. The Fallacy of Composition	
C. The Fallacy of Misplaced Blame	
Appendix: Reading Graphs	21

CHAPTER 2

<i>The Ways of Economics: Scarcity Underscored</i>	29
I. Two Ways of Approaching Economics	30
A. Microeconomics	
B. Macroeconomics	
II. Two Ways of Thinking About Economics	31
A. Problem Solving	
B. Dilemma Addressing	
III. Two Ways of Explaining Economics	33
A. Models	
B. Ceteris Paribus Conditions	
IV. Production Possibilities: What?, How?, Who?	34
A. Scarcity Diagrammed	
B. What? How? Who?	
V. Exchange Possibilities and Specialization	38
A. Exchange Possibilities	
B. Exchange and Specialization	
VI. Growth and Technological Change: What's New?	42
A. Introduction and Definitions	
B. Capital Investment (Input)	
C. Technological Change (Output/Input)	
VII. Circular Flow: How Stable?	45
A. Barter versus Money Exchange	
B. Final Goods Markets and Factor Markets	
C. How Stable? (Plus What?, How?, and Who?)	
Appendix: Adam Smith, The Founder of Economics	49

CHAPTER 3

The Market: Desirable Process and Results**53**

- I. Perfect Competition Defined** **54**
- II. Demand-Side Mechanics** **55**
 - A. Demand Defined
 - B. The Law of Demand
 - C. Shifts versus Movements Along the Demand Curve
- III. Supply-Side Mechanics** **62**
 - A. Supply Defined
 - B. The Law of Supply
 - C. Shifts versus Movements Along the Supply Curve
- IV. Demand and Supply Together: Equilibrium** **67**
 - A. Actual Price and Output
 - B. Surplus
 - C. Shortage
- V. Changes in Equilibrium** **69**
 - A. Shifts in Demand
 - B. Shifts in Supply
 - C. Shifts in Both Demand and Supply
- VI. Competitive Market Results: What? How? Who?
What's New? and How Stable?** **76**
 - A. What?
 - B. How?
 - C. Who?
 - D. What's New?
 - E. How Stable?

CHAPTER 4

The Role of Government**83**

- I. Problems of Procedure: Market Maintenance** **84**
 - A. Basic Upkeep
 - B. Correction of Market Imperfections
- II. Problems Regarding Results** **86**
 - A. Allocation Problems (Re: What? and a Bit of How?)
 - B. Distribution Problems (Re: Who?)
 - C. Promotion Problems (Re: What's New?)
 - D. Stabilization Problems (Re: How Stable?)
- III. Government Policies** **92**
 - A. Overview: Basic Tools
 - B. Specifics: Problems and Policies Together

IV. Problems with Government	99
A. Imperfections: Monopoly and Ignorance	
B. Allocation Problems	
C. Distribution Problems	
D. Promotion Problems	
E. Stabilization Problems	

CHAPTER 5

Basic Facts About American Business

107

I. Firms versus Establishments	108
A. Basic Definitions	
B. The Biggest Firms	
C. Smaller Firms	
II. Business Types	111
A. Sole Proprietorships	
B. Partnerships	
C. Corporations	
III. Corporate Finance: Stocks and Bonds	117
A. Common Stock	
B. Preferred Stock	
C. Bonds	
IV. The Stock Market	118

II

Macroeconomics: Measurement and Models

CHAPTER 6

<i>Twin Macroeconomic Problems: Unemployment and Inflation</i>	127
I. Unemployment	128
A. The Costs of Unemployment	
B. Types of Unemployment	
C. Unemployment: The Historical Record	
II. Inflation	132
A. The Inflation Rate	
B. The Costs of Inflation	
C. Inflation: The Historical Record	
III. Inflation and Unemployment	137

CHAPTER 7

<i>The National Income and Product Accounts</i>	141
I. Gross National Product	142
II. The Components of GNP	143
A. Consumption	
B. Investment	
C. Government Spending	
D. Net Exports	
III. National Income	145
IV. The Components of National Income	146
A. Compensation of Employees	
B. Corporate Profits	
C. Net Interest and Rental Income of Persons	
D. Proprietor's Income	
V. Personal Income and Personal Disposable Income	147
VI. Real versus Nominal GNP	148
VII. Alternative Price Measures	150
VIII. Cyclical Movements in Output	151

CHAPTER 8

<i>Getting Started: The Classical Macroeconomics</i>	155
I. The Keynesian Revolution	156
II. Aggregate Supply and Demand	156
A. Aggregate Supply	
B. Aggregate Demand	
C. Macroeconomic Equilibrium	
III. The Classical Model	158
IV. The Classical Theory of Supply	158
A. The Classical Labor Market	
B. The Classical Aggregate Supply Curve	
V. The Classical Theory of Money and Prices	162
A. The Equation of Exchange	
B. The Classical Aggregate Demand Curve	
VI. Stabilization Policy in the Classical System	164
A. Monetary Policy	
B. Fiscal Policy	

CHAPTER 9

<i>The Keynesian Theory of Aggregate Demand</i>	171
I. The Keynesian Income–Expenditure Approach	173
II. The Components of Aggregate Demand	173
A. Consumption	
B. Investment	
III. Equilibrium Output	179
A. Interpreting the Condition for Equilibrium Output	
B. The Tendency Toward Equilibrium	
IV. Equilibrium Output: A Numerical Example	182
V. Equilibrium Output: A Graphic Illustration	183
VI. Keynes versus the Classics: A First Look	185
Appendix: Equilibrium in the Keynesian System: An Algebraic Interpretation	187

CHAPTER 10

<i>The Government Sector, the Multiplier Concept, and Fiscal Policy</i>	189
I. A Model with a Government Sector	190
A. Equilibrium Output with a Government Sector	
B. Equilibrium Output: A Numerical Example	
C. Equilibrium Output: A Graphic Illustration	
II. Factors That Cause Changes in Equilibrium Output	195
A. The Change in Equilibrium Output with a Change in Investment	
B. The Autonomous Expenditure Multiplier	
III. Fiscal Policy	200
A. The Effect of a Change in Government Spending	
B. The Effect of a Change in Taxes	
C. The Balanced Budget Multiplier	
IV. Fiscal Stabilization Policy in the Keynesian Model	206
Appendix: An Algebraic Interpretation of the Simple Keynesian Model	209

CHAPTER 11

<i>Money and the Interest Rate</i>	213
I. The Definition of Money	214
A. The Functions of Money	
B. Components of the Money Supply	
C. Who Controls the Money Supply?	
II. The Role of Money: Keynes versus the Classics	216
III. The Keynesian View of the Money Market	217
A. Keynes's Theory of Money Demand	
B. The Money Supply and the Interest Rate	
IV. The Interest Rate, Aggregate Demand, and Equilibrium Output	219
V. Feedback Effects from Output to the Interest Rate	222
VI. Monetary Policy in the Keynesian System	223
VII. Fiscal Policy, the Interest Rate, and Crowding Out	223

CHAPTER 12

<i>The Complete Keynesian System: Aggregate Supply and Demand</i>	229
I. The Aggregate Demand Curve	230
A. The Slope of the Aggregate Demand Curve	
B. Shifts in the Aggregate Demand Curve	
II. The Keynesian Theory of Aggregate Supply	234
A. Rising Cost as Output Rises	
B. But Cost Rises Less Than Price	
III. Macroequilibrium in the Keynesian System	236
A. Shifts in the Aggregate Demand Curve	
B. Shifts in the Aggregate Supply Curve	
IV. Factors that Shift the Aggregate Supply Curve	239
A. Changes in Inflationary Expectations	
B. Supply Shocks	
Summary: Keynes versus the Classics	241

CHAPTER 13***Inflation and Unemployment: The Keynesian View* 245**

- I. Inflation and the Unemployment-Inflation Tradeoff 246**
 - A. Inflation and Aggregate Demand
 - B. Supply-Side Factors, Inflation, and the Unemployment-Inflation Tradeoff
- II. The Changing Nature of the Unemployment-Inflation Tradeoff 252**

CHAPTER 14***The Monetarist Counterrevolution* 257**

- I. Central Monetarist Themes 258**
- II. Longer-Run Self-Stabilizing Properties 258**
- III. Money Determines Money GNP 259**
- IV. The Natural Rates of Output and Employment 261**
 - A. Effects of an Increase in Money Growth
 - B. Policy Implications
- V. Noninterventionist Policy Conclusions 265**
 - A. Monetary Policy
 - B. Fiscal Policy
- VI. Monetarists versus Keynesians 267**
 - A. Longer-Run Self-Stabilizing Properties of the Economy
 - B. Money as the Dominant Influence on Money GNP
 - C. Monetarist Noninterventionist Policy Conclusions
 - D. The Monetarist-Keynesian Controversy: Evidence from the U.S. Experience

CHAPTER 15***The New Classical Economics* 275**

- I. Rational Expectations and the New Classical View of the Labor Market 277**
 - A. A Review of the Classical Labor Market Assumptions
 - B. The Keynesian and Monetarist Objections
 - C. The New Classical View
- II. Policy Implications of Rational Expectations 279**
 - A. Effects of a Predictable Increase in the Money Supply
 - B. Effects of a Monetary Surprise
 - C. Real-World Policy: Predictable or Surprising?

III. New Classical Policy Prescriptions	282
IV. The Keynesian Countercritique	282
A. The Realism of Rational Expectations	
B. The Role of Labor Market Contracts	
V. The New Classical-Keynesian Controversy: Some Evidence from the U.S. Experience	283
A. A Keynesian or Monetarist Explanation of the Data	
B. A New Classical Explanation of the Data	

CHAPTER 16

<i>Macroeconomics: Controversy and Consensus</i>	289
I. The Models in Pictures	290
A. Aggregate Supply	
B. Aggregate Demand	
II. Policy Conclusions	292
A. Keynesian Policy Conclusions	
B. Monetarist Policy Conclusions	
C. New Classical Policy Conclusions	
D. Classical Policy Conclusions	
III. Areas of Consensus	294

III

Macroeconomic Policy

CHAPTER 17

<i>Money and the Banking System</i>	299
I. Federal Reserve Control of the Money Supply	300
A. The Control Process	
B. Tools of Federal Reserve Control	
II. The Banking System and the Money Supply	305
A. Banks as Depository Institutions	
B. Bank Deposits and Bank Reserves	
C. A Simple Model of Deposit Creation	
III. Deposit and Money Multipliers	310
A. The Deposit Multiplier	
B. The Money Multiplier	
C. Deposit Creation: More Complex Cases	
IV. The Precision of Money Supply Control	313