

MACRO ECONOMICS

ROGER N. WAUD

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**UNIVERSITY OF NORTH CAROLINA
CHAPEL HILL**

**WITH "ECONOMIC THINKERS" ESSAYS BY
HUGH S. NORTON, UNIVERSITY OF SOUTH CAROLINA**

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PREFACE

One of this book's major aims is to demonstrate how principles of economics can be used to analyze real-world events and problems. Moreover, it presents these events and problems in the way that people usually encounter them—namely, via the news media. This approach is motivated by the view that a basic education in economic principles should develop the facility to apply an economic way of thinking to a news item of economic interest.

Economics professors are not readily available to the concerned citizen to help interpret the implications of the day's news. Those who report the news are often as befuddled by its meaning as those to whom they report. Clearly, it is not enough to know that economics is relevant. And it is not enough to understand basic economic principles spoon-fed from a textbook. Ultimately, a basic education in economic principles should develop a facility, indeed a habit, for disentangling and making sense out of the economic matters presented to us in our daily lives via the news media. Every chapter of this book uses real news reports to repeatedly demonstrate how to do this.

ADVICE FOR THE STUDENT

You don't have to have had a course in economics to be aware of economic problems. Newspapers, radio, and television bombard you with them daily. You no doubt are well aware of inflation, unemployment, and gasoline shortages. Tuition bills, finding a job, and just getting a few bucks to spend on a favorite pastime already have given you experience at economic problem solving. In short, you're not a novice to the subject of economics in the same way you might be to college physics. Nonetheless, economics is a rigorous subject. It should be studied in the same way that you would study a course in one of the sciences—a little bit *every day*.

Before reading a chapter always look at the learning objectives that are set out at the beginning. This will give you a brief outline of what you are about to read and what you want to learn from the chapter. Also, always read the news

item before proceeding with the chapter. Typically you will find the content of the news item puzzling. At various points in the chapter your attention will be drawn back to the news item as basic economic principles are developed that will enable you to understand the news story better. After you have read and studied the chapter, read the news item again. You should find that you have gained considerable insight into the main points it raises. You will find that the economic way of thinking, which at times may seem somewhat abstract, is a powerful tool for analyzing real-world problems. Also, after completing a chapter, you should go back and see how well you have accomplished the learning objectives set out at the beginning. This will provide a self-check on your grasp of the concepts and principles developed in the chapter.

When reading this book, read for understanding, not speed. Each chapter is broken into major sections that focus on important concepts. At the end of a major section, you will encounter a Checkpoint: a brief series of questions that will enable you to test your understanding of what you have just read. You should always stop and measure your progress with these Checkpoints.

Economics is a problem-analyzing discipline. In order to give you more practice, further questions are provided at the end of each chapter. Try your hand at these as well. Discuss them with fellow students and your instructor whenever you feel unsure about the answers. Further problems and questions designed for this book are contained in John E. Weiler's *Study Guide*. The *Study Guide* will give you considerable practice at economic problem solving and aid your understanding of important economic principles.

Beginning with Chapter 5, you will find a News Item for Your Analysis at the end of each chapter. The news item has been chosen because it illustrates many of the concepts and principles just developed in the chapter. You should read it and then try to answer the questions about it that follow. Doing so will help develop your ability to analyze economic events as you encounter them.

Finally, always bear in mind that the concepts and principles studied in each chapter are typically used again and again in subsequent chapters. Mastering the material as you go makes the chapters that follow that much easier.

TO THE INSTRUCTOR

Writing a principles text is an indulgence of ego—I felt it could be done better. I have been motivated in part by my experiences as a teacher and researcher. My exposure to the policy-making environment of the Federal Reserve Board, where I worked while on a two-year leave of absence from the university, provided added impetus.

As a teacher of principles, I have long felt that students need exposure to actual economic problems in a way that is also realistic—the way that people are in fact exposed to them every day. This led me to the strategy of presenting a news item at the beginning of every chapter, a news item that cries out for the application of the economic principles that are developed in the chapter. As the chapter unfolds, the news item then provides a convenient and obviously relevant vehicle for showing beginning students why the study of economics is useful. They don't have to be told it's useful—they can discover that fact as they go along.

In brief, not being satisfied with the presentation of economic principles and

policies in currently available texts, and not wishing to be evicted from the kitchen for taking up room and only complaining, I've decided to become a chef. Let me highlight what I think are the important features in my menu.

Macroeconomics

Recent years have brought new developments to the subject of macroeconomics. The standard Keynesian models that are used to teach principles students focus almost exclusively on total demand to explain the determination of total income, output, and employment. The rapid rise in the price of imported oil and other shocks to the supply side of the economy during the 1970s made it painfully apparent to instructors that aggregate supply must somehow be worked into the analysis. Without taking explicit account of aggregate supply, we have no way of explaining either cost-push inflation or the simultaneous occurrence of inflation and rising unemployment—the problem of stagflation. These concerns are so much a part of the contemporary world that students expect, and should receive, a meaningful analysis of them in an introductory course in economics. We owe it to them.

Such an analysis is one of the major innovations of this text. After developing the standard Keynesian aggregate demand model in Chapters 7 and 8, the concept of aggregate supply is introduced. The last major section of Chapter 8 shows the relationship between total demand and supply and illustrates why it is possible to have an increase in the general price level and the unemployment rate at the same time. This framework is used in Chapter 13 to facilitate a comparison of Keynesian and monetarist views. More significantly perhaps, it provides a framework for the analysis of stagflation and the contemporary problems of fiscal and monetary policy in Chapter 14. I should emphasize that *the standard Keynesian income analysis, with which instructors are so familiar, is fully developed in this text*. There is no scrimping on that. But the supply side of economy is then integrated with this analysis in a carefully explained fashion to enable the instructor to deal with cost-push inflation, supply shocks to the economy, and the problem of stagflation and its policy implications.

Inflation is a topic that calls for and receives extensive treatment in this text. The questions of who gains and who loses from inflation, and why, are addressed early on in Chapter 6. Cost-push and demand-pull inflation are first dealt with in Chapter 8, and in the comparison of Keynesian and monetarist views in Chapter 13. The problem of inflation obviously figures prominently in the discussion of stagflation and the problems of contemporary fiscal and monetary policy in Chapter 14. Roughly two-thirds of Chapter 15 is devoted to an analysis of wage-price guidelines and controls, their effectiveness and shortcomings, and the question of indexing. There we examine recently proposed guideline policies such as wage insurance and the tax-based income policy (TIP), as well as the indexing of income and capital gains taxes, and the indexing of government bonds and other financial assets. Chapter 15 also examines methods for dealing with unemployment other than the conventional tools of fiscal and monetary policy. These include manpower programs of the 1960s and 1970s, public works projects, and the concept of employment tax credit that has received much attention in recent years.

Another major feature of the text is an explicit treatment of the implications for the economy of the way in which government budget deficits are financed. Too often, it seems to me, currently available texts do not give sufficient attention to these implications. Yet they figure prominently in the comparison of the Keynesian and monetarist views, particularly as they relate to the issue of crowding out and the effectiveness of fiscal and monetary policy discussed in Chapter 13. These implications are also quite relevant to the discussion of the contemporary problems of fiscal and monetary policy and to the stagflation dilemma discussed in Chapter 14. There I set out an analysis of the current problems of macroeconomic policy that, I find, students want ("Why are we in such a mess?") but in my opinion is not given in currently available principles texts.

Money, the money supply process, and financial institutions are given careful coverage in Chapters 10, 11, and 12. Chapter 12 brings money and the interest rate explicitly into the model. I believe that the treatment has benefited from my own experience and research activities in this area.

On Explaining Things

It may seem an odd pitch to make about a textbook, but this book places an emphasis on explanation. In recent years many economics principles texts seem to put a premium on being terse—even to the point of being "slick." But there is a trade-off between brevity and explanation. Given the need to explain, the ideal is to be as brief as possible but not briefer than necessary. As a practical matter, books typically and unavoidably end up somewhat to one side or the other of the ideal. I have decided that, if I am condemned to err, I would opt for explaining too much rather than too little. Every effort has been taken to make the book as readable as possible. Numerous examples are provided to give concreteness to difficult concepts.

MORE ABOUT THE NEWS ITEMS AND OTHER FEATURES AND INNOVATIONS

News Items

Every chapter begins with a news item based on a bona fide newspaper article (most often, but not always, taken from the *Wall Street Journal*). Each news item has been selected because it illustrates economic problems and concepts that are directly related to the economic principles to be developed in the particular chapter. As these principles are developed during the course of the chapter, it is shown how they can be applied to clarify and provide understanding of the economic problems discussed in the news item. Hence, in addition to engaging the student's attention in a relevant way at the outset of each chapter, the news item and the subsequent references to it aid in showing how and why economic analysis is a powerful and useful tool. *Care was taken to select news items that are as enduring as the fundamental economic principles they illustrate. The names of the actors may change but, in almost every case, the central themes most likely will be as timely a generation from now as they are today.*

News Items for Your Analysis: Case Studies

In order to give the student practice in analyzing economic problems as they are presented in the news, News Items for Your Analysis are presented at the end

of every chapter starting with the fifth chapter. Like those at the beginning of each chapter, each end-of-chapter news item is adapted from an actual newspaper article that directly illustrates the basic economic principles developed in the chapter. However, end-of-chapter news items are generally, though not always, somewhat longer and more elaborate. The questions which follow the article encourage the student to apply the economic principles just learned. The end-of-chapter news items and the questions about them constitute case studies typical of those that we encounter every day.

Checkpoints

Checkpoints appear throughout every chapter, generally at the end of major sections. At each Checkpoint the student is signaled to stop and answer a series of questions about concepts just presented—to stop and check on his or her progress and grasp of the material. Questions and problems placed at the end of chapters are all too often easily ignored, like so much litter at the back of a closet that one is rarely forced to face. The Checkpoints are intended to get around this problem and help the student to reconsider what has just been read. They try to check on the student's understanding of concepts as they are encountered, rather than after many curves and several compounded misunderstandings accumulated at the journey's end. Often the Checkpoints will include questions that require the student to apply a concept just learned to a particular aspect of the news item at the beginning of the chapter. Frequently, the Checkpoints provide grist for class discussion.

Learning Objectives

Learning objectives are listed and set off from the main text at the beginning of each chapter. They outline a plan of study for the chapter as well as provide an overview of what's to be done. After completing the chapter, the student can also use the list of learning objectives as a quick check to see whether the material in the chapter has been mastered or not.

Economic Thinkers

These are biographies of famous economists and others who have had a significant impact on economic events and economic thinking. They are not so much personal biographies as studies in the history of economic thought. Their major purpose is to highlight the development of economic thinking on major problems and concerns while indicating the significant role that particular individuals have played in this development.

Key Terms and Concepts

Terminology is unavoidably abundant in economics. In addition, words that have several meanings in common everyday usage often have a more precise meaning when used in economics. Such words, along with other important economic terms, appear in boldface type whenever they are first introduced and defined in the text. Key Terms and Concepts, at the end of each chapter, lists these. These terms and concepts are defined again in the Glossary at the end of the book.

Summaries

The Summaries at the end of each chapter are fairly comprehensive. They are intended to tie together the main concepts developed in the chapter as well as alert the student to areas that may require rereading.

Questions and Problems

Questions and Problems are also located at the end of each chapter. These are generally more complex and extended than the questions found in the Checkpoints. Some are almost case studies. Many may be readily used for class discussion. The News Items for Your Analysis appear after the Questions and Problems. The Checkpoints, the Questions and Problems, and the News Items for Your Analysis, with its Questions, provide significantly more in-text questions, problems, and case studies with questions than are provided by most economic principles texts currently available.

Figures, Graphs, and Tables

There is liberal use of real-world data that appear in tables and figures throughout the book. Quite often tables containing hypothetical data are used to illustrate particularly difficult concepts. Graphs and figures are also used extensively—more liberally than in most principles texts. The captions describing each graph and figure generally begin with a brief summary statement followed by a reasonably complete description of what is portrayed.

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