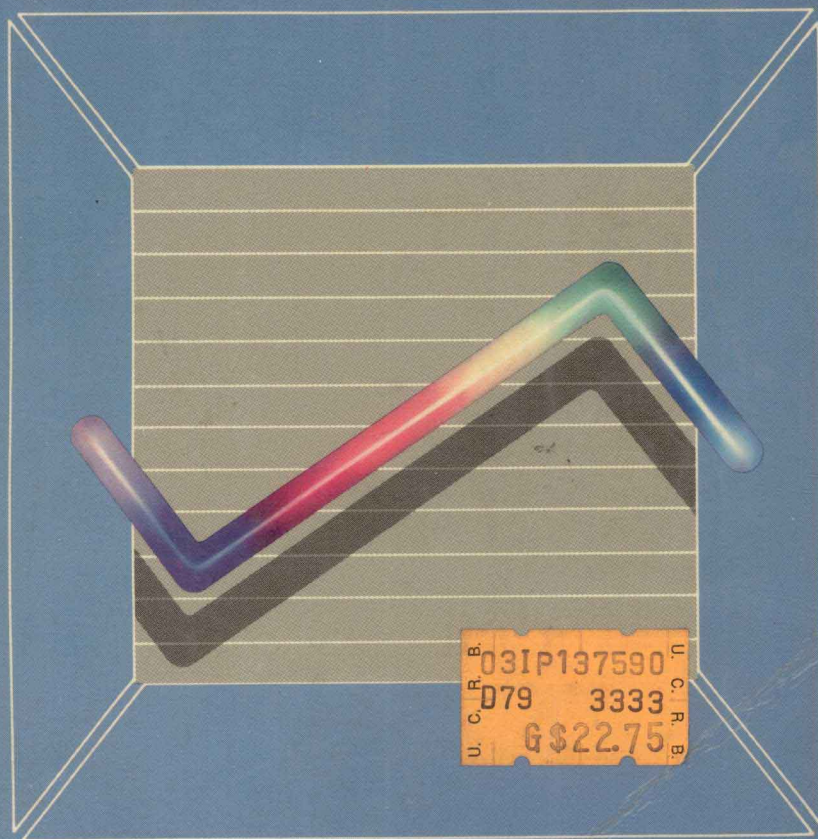


ECONOMICS

PRINCIPLES AND POLICY

MACROECONOMICS



F O U R T H E D I T I O N

WILLIAM J. BAUMOL
ALAN S. BLINDER

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Harcourt Brace Jovanovich, Publishers

and its subsidiary, Academic Press

San Diego New York Chicago Austin Washington, D.C.
London Sydney Tokyo Toronto

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ISBN: 0-15-518853-4

Library of Congress Catalog Card Number: 87-81895

Printed in the United States of America


Note: This work is derived from *Economics: Principles and Policy*, Fourth Edition by William J. Baumol and Alan S. Blinder. Copyright © 1988, 1985, 1982, 1979 by Harcourt Brace Jovanovich, Inc.

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Preface

For decades, the “principles of economics” book has been expected to codify the entire discipline of economics. In recent years, this has become at once more difficult and more imperative. The explosion of economic knowledge has made it impossible to put all of economics between two covers. But at the same time, more and more public policy issues either are basically economic in nature or involve important economic considerations. Intelligent citizens can no longer afford to be innocent of economics.

The preparation of this Fourth Edition continued to be guided by this dilemma. We have studiously avoided the encyclopedic approach and abandoned the fiction, so popular among textbook writers, that literally everything is of the utmost importance. Since students are sufficiently intelligent to see through this ruse in any event, we have tried to highlight those important ideas that are likely to be of lasting significance—principles that you will want to remember long after the course is over because they offer insights that are far from obvious, because they are of practical importance, and because they are widely misunderstood by intelligent laymen. A dozen of the most important of these ideas have been selected as **12 Ideas for Beyond the Final Exam** and are called to your attention when they occur through the use of the book’s logo. 

All modern economics textbooks abound with “real world” examples, but we have tried to go beyond this, to elevate the examples to preeminence. For in our view, the policy issue or everyday economic problem ought to lead the student naturally to the economic principle, not the other way around. For this reason, many chapters start with a real policy issue or a practical problem that may seem puzzling or paradoxical to noneconomists, and then proceed to describe the economic analysis required to remove the mystery. In doing this, we have tried to utilize technical jargon and diagrams only where there is a clear need for them, never for their own sake.

Still, economics is a somewhat technical subject and, except for a few rather light chapters, this is a book for the desk, not for the bed. We have, however, made strenuous efforts to simplify the technical level of the discussion as much as we could without sacrificing content. Fortunately, almost every important idea in economics can be explained in plain English, and this, in general, is how we have tried to explain them. Yet, even while reducing the technical difficulty of the book, we have incorporated some elements of economic analysis that have traditionally been left out of introductory books but that are really too important to omit.

Foremost among these is our extensive treatment of prices and inflation in Parts 2 through 5. For years, textbooks devoted many chapters to unrealistic but simpler economic models in which prices never rose. Ours was the first introductory text to put inflation into the story from the very beginning, rather than as an afterthought—a practice we maintain and expand in the Fourth Edition.

Changes from the Third Edition

The most notable change in the Fourth Edition is the greater “internationalization” of the book, reflected especially in two new chapters and considerable reorganization of Part 4. *Economics: Principles and Policy* now places much more emphasis on the world economy and America’s place in it. Recent events necessitate this reorientation. Students simply cannot understand the major economic controversies of the day—over large budget and trade deficits, dramatic swings in exchange rates, and international coordination of economic policy, for example—without a deeper understanding of international economics. Such issues are in the newspapers every day and promise to play a role in the 1988 presidential campaign and beyond.

International economics is the focus of Part 5 (“The United States in the World Economy”). Chapters 18 and 19 are extensively updated and revised, and Chapter 20 (“Macroeconomics in a World Economy”) is entirely new. We think it is by far the most extensive treatment of open-economy macroeconomics to be found in any major principles textbook.

Although open-economy macroeconomics has long been standard fare in Europe and Canada, it has traditionally been considered too difficult for the principles course in the United States. However, we have concluded that the subject is far too important to omit and have therefore prepared an elementary treatment geared to the needs of the contemporary American student. Specifically, we avoid the traditional taxonomic approach by concentrating on the case that is most relevant to the contemporary United States: a large economy with a floating exchange rate and high (but not perfect) capital mobility.

The other new chapter is Chapter 7 on productivity (“Productivity, Progress, and Prosperity”), which represents a complete revision of Chapter 20 of the Third Edition. Not only does it come much earlier in the book, but it now has a much more international and historical flavor; it is intended to help students place our economy in a broader perspective. Finally, references to open-economy aspects of macroeconomics are sprinkled throughout Parts 3 and 4.

To make room for the new Chapter 20, we have consolidated materials that formerly took up six chapters into five (current Chapters 13–17). This required considerable reorganization, a little pruning, and some longer chapters. The ordering of certain topics differs from the Third Edition’s but, in many ways, is more logical. For example, everything pertaining to the Keynesian–monetarist controversy now appears in a single chapter (Chapter 15), rather than being scattered over three chapters.

Most of the other macroeconomic chapters will look familiar to users of previous editions, although few paragraphs survived untouched. Some changes are worth noting, however. There is, of course, extensive revision and updating of the materials on Reaganomics and the events of the 1980s, especially in Chapters 5, 11, 12, and 16. Both Chapter 11’s explanation of the aggregate supply curve and Chapter 13’s explanation of deposit creation have been rewritten, based on helpful suggestions from readers. Chapter 14 has a new section explaining the

relationship between bond prices and interest rates, and Chapter 17 has one on Martin Weitzman's "share economy" proposal.

Studying Principles of Economics

Whatever the nature of your course, we would like to offer one suggestion. Unlike some of the other courses you may be taking, principles of economics is cumulative—each week's lesson builds on what you have learned before. You will save yourself a lot of frustration (and also a lot of work) if you keep up on a week-to-week basis. To help you do this, there is a chapter summary, a list of important terms and concepts, and a selection of discussion questions to help you review at the end of each chapter. In addition to these aids, many students will find the *Study Guide*, designed specifically to accompany this text by Professor Craig Swan, helpful as a self-testing and diagnostic device. When you encounter difficulties in the *Study Guide*, you will know which sections of the text you need to review.

Note to the Instructor

In trying to improve the book from one edition to the next, we rely heavily on our own experiences as teachers. But our experience using the book is minuscule compared with that of the hundreds of instructors who use it nationwide. If you encounter problems, or have suggestions for improving the book, we urge you to let us know by writing to either one of us in care of Harcourt Brace Jovanovich, College Department, 1250 Sixth Avenue, San Diego, California 92101. Such letters are invaluable, and we are glad to receive them, even if they are critical.

What follows is a set of suggested course outlines.

OUTLINE FOR A ONE-SEMESTER COURSE IN MACROECONOMICS

Chapter Number	Title
1	What Is Economics?
2	The Use and Misuse of Graphs
3	Scarcity and Choice: <i>The Economic Problem</i>
4	Supply and Demand: An Initial Look
5	Macroeconomics and Microeconomics
6	Macroeconomic Maladies: Unemployment and Inflation
7	Productivity, Progress, and Prosperity
8	Income and Spending: The Powerful Consumer
9	Demand-Side Equilibrium: Unemployment or Inflation?
10	Changes on the Demand Side: Multiplier Analysis
11	Supply-Side Equilibrium: Unemployment <i>and</i> Inflation?
12	Fiscal Policy and Supply-Side Economics
13	Money and the Banking System
14	Monetary Policy and the National Economy
15	The Keynesian–Monetarist Debate
16	Budget Deficits and the National Debt: Fact and Fiction
17	The Trade-Off Between Inflation and Unemployment
18	International Trade and Comparative Advantage
19	The International Monetary System: Order or Disorder?
20	Macroeconomics in a World Economy
21	Growth in Developed and Developing Countries

OUTLINE FOR A ONE-QUARTER COURSE IN MACROECONOMICS

Chapter Number	Title
1	What Is Economics?
2	The Use and Misuse of Graphs
3	Scarcity and Choice: <i>The Economic Problem</i>
4	Supply and Demand: An Initial Look
5	Macroeconomics and Microeconomics
6	Macroeconomic Maladies: Unemployment and Inflation
8	Income and Spending: The Powerful Consumer
9	Demand-Side Equilibrium: Unemployment or Inflation?
10	Changes on the Demand Side: Multiplier Analysis
11	Supply-Side Equilibrium: Unemployment <i>and</i> Inflation?
12	Fiscal Policy and Supply-Side Economics
13	Money and the Banking System
14	Monetary Policy and the National Economy
15	The Keynesian–Monetarist Debate
16	Budget Deficits and the National Debt: Fact and Fiction
17	The Trade-Off Between Inflation and Unemployment

With Thanks

Finally, and with great pleasure, we turn to the customary acknowledgments of indebtedness. Ours have been accumulating now through four editions. In these days of specialization, not even a pair of authors can master every subject that an introductory text must cover. Our friends and colleagues Charles Berry, Rebecca Blank, William Branson, Lester Chandler, Gregory Chow, Avinash Dixit, Robert Eisner, Stephen Goldfeld, Claudia Goldin, Ronald Grieson, Daniel Hamermesh, Peter Kenen, Melvin Krauss, Arthur Lewis, Burton Malkiel, Edwin Mills, Janusz Ordovery, Uwe Reinhardt, Harvey Rosen, Carl Shapiro, Hans Soderstrom, Laura Tyson, and Martin Weitzman have all given generously of their knowledge in particular areas over the course of four editions. We have learned much from them, and only wish we had learned more.

Many economists at other colleges and universities offered useful suggestions for improvements, many of which we have incorporated into the Fourth Edition. We wish to thank J. David Bowman of State University of New York—Oswego, Gerald Breger of University of South Carolina, Hsin Chang of University of Michigan, Carol Clark of Guilford College, Elizabeth Crowell of University of Michigan, Elizabeth Dickhaus of University of Missouri—Columbia, Patricia Euznet of University of Central Florida, Marianne Felton of Indiana University, Richard Fritz of University of Central Florida, Phillip Gilbert of Mira Costa College, Jonathan Goldstein of Bowdin College, Joseph Guerin of Saint Joseph's University, Thomas Hamer of Glassboro State College, James Hanson of Willamette University, Richard Harmstone of Pennsylvania State University, Benjamin Hitchner of Glassboro State College, John Isbister of University of California—Santa Cruz, Hassan Khademan of University of Missouri—St. Louis, Wolfgang Mayer of University of Cincinnati, John Mogab of Southwest Texas State University, David Ramsey of Illinois State University, Neil Reznik of Community College of Philadelphia, Steven Rock of Illinois Institute of Technology, Gary Sellers of University of Akron, Scott Sumner of Bentley College, Robert Thomas of Iowa State University, Roger Trenary of Kansas State University, Wayne Wangsness of Luther College, Walter Wessels of North Carolina State University, Travis Wilson of DeKalb Community College, and Anthony Zambelli of Cuyamaca College.

We also wish to thank the many economists who responded to our questionnaire; their responses were invaluable in planning this revision: Nick Adnett of California State University—Sacramento, Lori Alden of California State University—Sacramento, Polly Allen of University of Connecticut, Sandra Alvis of North Carolina State University, Kenneth Arakelian of University of Rhode Island, Robert Baade of Lake Forest College, Moshen Bahmani of University of Wisconsin, Barbara Bladwin of Diablo Valley College, Douglas Barnett of Biola University, Nancy Barry of Baldwin-Wallace College, Klaus Becker of Ohio University, Dwight M. Blood of Brigham Young University, Ronald Braeutigan of Northwestern University, Philip Bryson of University of Arizona, Judy Butler of Baylor University, David Butz of Northwestern University, Wendy A. Campione

of Northern Arizona University, Thomas M. Carroll of Central Oregon Community College, Paula Cech of University of Arizona, Darrel Christy of University of Wisconsin, Carolyn Clark of Washington State University, Paul Coomes of University of Louisville, Granger Coudle of University of Colorado at Boulder, Dan Dabney of Southwest Texas State University, Rosalee Danielson of Illinois State University, Gary Dymski of University of Southern California, James Eaton of Bridgewater College, David Emery of St. Olaf College, Carol Engle of Auburn University—Montgomery, Homer Erikson of Miami University, Paul Farnham of Georgia State University, Ellen Foster of State University of New York—Albany, Jack Fulcher of University of Nebraska—Omaha, Albert Gray, Jr., of Baldwin-Wallace College, John Green of University of Northern Colorado, W. Clayton Hall of Illinois Institute of Technology, Thomas Hatcher of Fordham University, Charles Hegji of Auburn University—Montgomery, Bruce Herrick of Washington and Lee University, Harold H. Hiskey of Southern Utah State College, Paul Huszar of Colorado State University, Robert Jensen of Pacific Lutheran University, William Kammrath of Concordia College, Bruce Kanago of Miami University, Robert Walter Kerr of College of Lake County, Kusum Ketkar of Seton Hall University, Jong Seok Kim of Dartmouth College, Lori Kletzer of Williams College, L. Emil Kreider of Beloit College, Dale Kuntz of Bentley College, Thomas Leary of University of North Carolina—Greensboro, Michael Leonesio of University of Missouri, Dennis Leyden of University of North Carolina—Greensboro, John Wakeman-Linn of Williams College, R.F. Litro of Mattatuck Community College, John Lyons of Miami University, Bruce Mann of University of Puget Sound, Barbara Marcus of Davenport College of Business, Rebecca Marton of Nicholls State University, Lester McAllister of Beloit College, Peter McKay of Bakersfield College, Richard Megna of Kansas State University, Ruby Pandey of Southwest Texas State University, Theodore Paulos of Eastern Montana College, Rosemary Peavler of Morehead State University, Charles Revier of Colorado State University, Bruce Roberts of College of William and Mary, Robert Robertson of Indiana State University, Steve Russell of Arizona State University, Stephen Sacks of University of Connecticut, John Shaw of California State University—Fresno, John Shieh of California State Polytechnic University, William Sloan of North Carolina State University, John Ewing-Smith of Burlington County College, Steven Smith of Bakersfield College, Shane Stevens of Bridgewater College, Mary Stevenson of University of Massachusetts—Boston, Gabriel Talmain of State University of New York—Albany, Kenneth Taylor of Villanova University, Nita Thacker of State University of New York—Albany, Carolyn Tuttle of Lake Forest College, Terry Von Ende of Ohio University, Dale Warnke of College of Lake County, Chris Weber of University of North Carolina—Greensboro, Mark Weglarski of Macomb County Community College, Cathleen Whiting of Willamette University, John Wolfe of Michigan State University, William Wood of Bridgewater College, and William P. Yohe of Duke University.

We were, of course, most gratified by a number of spontaneous and kind letters from student readers. Since it is for such readers that the book is primarily intended, no other comments have meant as much to us.

The book you hold in your hand was not done by us alone. The fine people at Harcourt Brace Jovanovich, including Mimi Egan, Margie Rogers, Bruce Daniels, Lynn Edwards, Rebecca Lytle, and Diane Pella, worked hard and well to turn our manuscript into the book you see. We appreciate their efforts.

Our sanity and survival during the preparation of the Fourth Edition were assured by the intelligence, ability, and pleasantness of our secretaries, Phyllis Durepos and Karen Garner-Lipman, who did so many things and did them all so well. Sue Anne Batey Blackman, who seems to know our thoughts on the subject better than we do ourselves, besides catching a number of mistakes, brought up to date the chapter on the environment and the economics of natural resources. She and, more recently, Vacharee Devakula have both provided superb assistance.

And finally there are our wives, Hilda Baumol and Madeline Blinder. They have now participated in this project a dozen years, and with each successive revision they help in more and more ways. Their patience, good judgment, and love have made everything go more smoothly than we had any right to expect. This we appreciate deeply.

William J. Baumol
Alan S. Blinder

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*Some of the Ideas for Beyond the Final Exam are in this textbook; others are in *Microeconomics: Principles and Policy* by Baumol and Blinder.

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