

Principles of Macroeconomics

Fleisher/Ray/Kniesner

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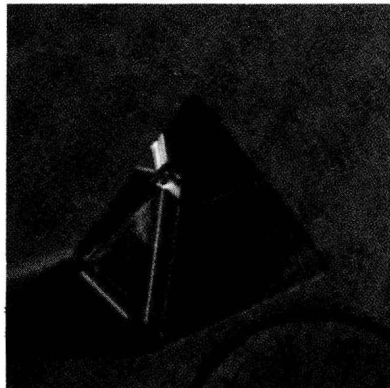
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To

Don and David

*Beth, Stephanie, Katherine,
and Michael*

Grace

Contents

Expanded Contents vi

Preface xv

Acknowledgments xix

Part I

Introduction

- 1 Scarcity, the Three Questions of Economics, and an Economic System 5

Part II

Introduction to Macroeconomics

- 2 Introduction to Macroeconomics 31
- 3 Employment, Unemployment, and the Aggregate Production of Goods and Services 65
- 4 Aggregate Expenditure on Goods and Services 89
- 5 Money and the Banking System 115
- 6 The Central Bank and Regulation of Money and the Banking System 131
- 7 Money, Credit, and the Rate of Interest 149

Part III

Macroeconomic Policy

- 8 How the Macroeconomy Works 171
- 9 Aggregate Demand, Aggregate Supply, and the Price Level 189
- 10 Fiscal and Monetary Policies 213
- 11 Monetary and Fiscal Policies in Action 233
- 12 Summing Up: Macroeconomic Controversies 251

Part IV

The International Economy

- 13 Trade among Nations 273
- 14 The Regulation of International Trade 293
- 15 Monetary and Macroeconomic Aspects of International Trade 313
- 16 Current Issues in International Trade 335

Part V

Economic Growth and Comparative Systems

- 17 Economic Growth and Change 363
- 18 Alternative Economic Systems 375

Appendix A: Graphs 401

Appendix B: How to Solve Policy Issues 407

References 409

Glossary 413

Index 421

Preface

What? Still one more principles text?

Yes. The reason we believe that we can contribute something of value to the already crowded field of introductory economics textbooks is that none of the other existing books matches our needs in teaching *Principles of Macroeconomics*. Needless to say, we hope that others perceive some of the needs that we have tried to address. We desired a text that uses a building-block approach, which means that each theoretical tool is developed on the basis of what has gone before, without time- and space-wasting repetition and without theoretical gaps or inconsistencies. Our goal has been a book that illustrates in every chapter the applicability of economic analysis to important social problems and integrates our knowledge of the economic process with social choices made in a political context. We also wanted a text that would be more effective than any other now available in helping students to understand the role of the United States in the rapidly changing international economy and to appreciate the political-economic problems faced by the world's developing nations. Finally, we believe it is crucial that the beginning student grasp the fundamental interrelationships between the real economy and monetary economy (microeconomics and macroeconomics). This requires understanding the "microfoundations" of the determination of unemployment, interest rate, price level, and aggregate production. However, we wanted to avoid the burden of the complex IS-LM analysis that is usually relegated to an appendix in other texts (if it appears at all). Pedagogically, we wished to avoid a text cluttered with "boxed inserts" that, in our judgment, divert students' attention from basic, important issues in economics.

Principles of Macroeconomics has been written on the assumption that a few tools, well-learned, provide insights that are unavailable to those who have not studied modern economic analysis. It serves as a summary of basic principles for those who may never enroll in another course beyond the usual two-term introductory sequence and as a foundation for additional courses taken by economics majors and business students. We have strived to keep theoretical analysis simple, yet correct, so that nothing need be "unlearned" by students going on to intermediate or graduate level course work. Numerous applications of economic analysis to policy issues are linked to an analysis of the political process through which social policies are developed. A broad spectrum of policy applications is covered, including health economics, agriculture, technological progress, poverty, the problems of the world's developing nations, current international economic problems, and more. Students' understanding of policy formulation is enhanced by repeated analysis of "winners" and "losers" from alternative policies and how their political power influences actual policy decisions.

► Organization

Part I is comprised of a single chapter that introduces the fundamental economic principles of scarcity, the *What, How, and For Whom* questions, the production possibilities frontier, opportunity cost, and comparative advantage, with some attention-grabbing applications, including the economics of life and death choices and the 55-mph speed limit. The role of economic theory and the distinction between positive and normative analysis are discussed.

Part II is the first macroeconomics section. Chapter 2 defines macroeconomics and introduces GNP and the other principal aggregate economic variables, the price level, interest rate, and unemployment. The appendix to this chapter summarizes the important factors of supply and demand that instructors can cover macroeconomics without having to cover microeconomics first. In fact, each element of supply, demand, and the equilibrium concept is introduced and defined within the main body of chapter 3, as well, so those instructors who wish to use their course time to cover applied topics more intensively can skip the appendix to chapter 2 without loss of required information in the macro course.

Chapter 3 introduces the labor market, a crucial microfoundation of modern macroeconomics. Chapter 4 describes the aggregate expenditure on goods and services that leads to a particular level of GNP in the goods market. The student is continuously reminded that full macroeconomic equilibrium depends on conditions in the labor market, as well, and that equilibrium in the goods market may or may not correspond to "full employment." Chapters 5, 6, and 7 introduce the financial sector and describe the determination of the interest rate, using a loanable funds approach. We believe that we are unique in using the loanable funds approach to link the real and monetary sectors and that this pedagogical device allows the student to learn much more about the mutual interaction of exogenous expenditure components with the interest rate and monetary and fiscal policies than is possible with any other existing text.

In Part III, we tie the labor, goods, and credit markets together to develop a model of general macroeconomic equilibrium in chapter 8. We use the model to illustrate what happens in each market

during recessions and inflationary periods. Chapter 9 emphasizes determination of the price level, using the quantity theory and aggregate demand and supply. Chapters 10, 11, and 12 introduce fiscal and monetary policies in theory and practice. Our approach is unique in that the student does not have to unlearn the partial equilibrium aspects of fiscal policy that hinder understanding of how government expenditure and taxation policies interact with interest rate determination. Chapter 12 summarizes major issues in macroeconomics by comparing Keynesian, monetarist, and supply-side policies.

Part IV introduces international economics. Chapters 13 and 14 cover "real" trade, using the concepts of supply and demand to analyze imports, exports, and tariff and nontariff trade barriers. Chapter 15 covers monetary and macroeconomic trade issues, including exchange rate determination and the balance of payments. Chapter 16 addresses various current issues in the international economy, including the impact of OPEC on the world's developed and developing nations.

Part V includes the capstone chapters on economic growth and comparative systems. Once again, the applications of economic tools and empirical issues are stressed. In chapter 17, particular attention is paid to the productivity slowdown in the United States and to the role of "industrial policy" in economic development. Chapter 18 compares the allocation mechanisms of free market and mixed economies with those of planned, socialist economies and emphasizes a comparison of various measures of social and economic welfare between the planned economies and those of the other industrialized nations. This chapter also contains an appendix that deals with the theory of public choice.

► Pedagogy

Principles of Macroeconomics offers a variety of pedagogical aids for students and teachers. Each chapter opens with a chapter outline, learning objectives, and a prologue/scenario as part of the introduction. The introduction provides a real-world lead-in to the material and relates chapter content to previous and subsequent chapters. A running glossary is presented at the top of each page. The key terms are also listed and page referenced at the end of the chapter. Numerous end-of-chapter questions aid student comprehension of the material.

Each major section of the text concludes with a feature called Policy Issue. These policy puzzles direct students to put themselves in the position of an economic policymaker and formulate decisions regarding the issues presented. An appendix at the back of the book instructs students on how to analyze and work through the policy puzzles.

The careful use of appendices aids students in understanding the use and relevance of economic tools and concepts. The “careers” appendix after chapter 1 shows students the relevance of the subject to their future careers; it contradicts the notion that economics is a dismal science. The supply/demand appendix following chapter 2 provides condensed coverage of basic supply and demand concepts. Instructors can use this appendix to teach macroeconomics without unnecessary detail. Several other chapter-end appendices present mathematical analyses of material contained in the related chapters, allowing a clearer focus on concepts and applications in the body of the chapters.

The text contains numerous direct and rhetorical questions designed to get the student to think more deeply about economic principles and applications discussed. Outlines of answers to these questions are provided in the instructor’s manual.

There are numerous applications of such important contemporary topics as public choice analysis, the economics of information, the economics of the allocation of time, and rational expectations. These applications repeatedly stress the political, or “public choice” ramifications of policy formation. At the same time, the authors have carefully avoided taking sides politically, while emphasizing the political limits on economic policymakers.

There is a distinct pedagogical advantage to our use of loanable funds analysis in developing a macroeconomic model of both the real and monetary sectors. Most texts use the loanable funds model in microeconomic analysis of the interest rate, but then drop it in the macro portion of the text. Some texts use the loanable funds theory of interest in describing how monetary policy works but do not integrate this analysis with the goods market and fiscal policy. This gives the appearance of two different theories of the interest rate and macroeconomic policy, which can only leave students confused. Our use of the loanable funds analysis of interest rates, depending only on the tools of supply and demand and combined with the microfoundations of supply and demand for labor, determination of real wage rates, and unemployment, shows how microeconomics applies to an understanding of the complex interrelationships of the macroeconomy. The loanable funds approach illustrates directly how monetary and fiscal policies are *related* means of achieving macroeconomic stability. The impacts of monetary and fiscal policies on GNP, employment, the interest rate, real investment, and the price level are easily compared. The power of this approach has enabled us to include brief histories of the Great Depression and economic experience in the United States since the 1960s that are superior in depth and scope to any existing principles text. The loanable funds approach is equally well adapted to a Keynesian or monetarist orientation, and the text clearly and succinctly explains the distinctions between modern Keynesians, monetarists, and supply siders in terms of the macroeconomic tools developed.

► Teaching and Learning Aids

For the Instructor

Instructor's Manual: Each chapter includes a chapter outline with teaching tips, suggested answers to all end-of-chapter questions, and a set of additional readings from recent magazines and newspapers.

Transparencies: Forty-seven colorful acetates of selected economic diagrams facilitate instruction and learning.

Test Bank: Approximately 1,000 questions that have been carefully designed using guidelines established by the Joint Council on Economic Education. The questions are also available on complimentary **wch** TestPak computer diskettes for instructors adopting the book.

Transparency Masters: Twenty-eight transparency masters and the test bank are included in the Instructor's Manual.

QuizPak: A student self-testing program offered free to adopters of *Principles of Macroeconomics*. Your students can review course material by quizzing themselves on the microcomputer. All questions in QuizPak are different from those in the Test Bank!

Software: Computer software will be available to help your students learn the principles of macroeconomics. The computer programs are designed to reinforce key concepts in the book.

For the Student

Student Study Guide: Each chapter contains an overview that summarizes the basic concepts introduced in each text chapter, a vocabulary check that reviews the key terms and definitions in the text, and numerous self-testing items, including true-false and multiple-choice questions and answers. Each chapter also contains at least one exercise and its solution.

StudyPak: An interactive student study guide on the microcomputer available for students to purchase. Students will review study materials selected for a particular text chapter and receive instant feedback. Printed study materials supplement the program to provide maximum coverage of each text chapter.

► Highlights

To highlight the significant features of our text, we have summarized some of them below:

1. Uses a building-block approach that stresses the applicability of supply and demand analysis throughout.
2. Extensive policy applications to the household, business, health care, and government sectors and to developing nations.
3. Simply presented and current data.
4. A tools-oriented approach to the economist's way of thinking.
5. A unique, loanable funds approach to macroeconomics that facilitates incorporation of real and monetary disturbances in the basic macro model.
6. Stresses the microfoundations of macroeconomics.
7. Three chapters devoted to macroeconomic policy, including a unique historical analysis of two major episodes that continue to influence our lives today and an up-to-date comparison of Keynesian, monetarist, and supply-side policy positions.
8. Macroanalysis that focuses on the three crucial policy variables, inflation, unemployment, and interest rates.
9. Up-to-date analysis of the international economy as it affects the United States and the world's less-developed and -industrialized nations.
10. Fresh applications to the important policy areas of income distribution, externalities, public choice, international trade, and international financial problems.
11. Application of basic economic principles to the problems of developing nations.
12. Emphasis on comparing ideal policies with those that are practicable as determined by the reality of politics and the relationships of government to society.
13. Emphasizes international economic issues (most complete treatment available).

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Kenneth Kopecky graciously released rights to material from an earlier work, and the present text owes much to his influence. We also appreciate the cooperation of David Terry Paul in making publication of this book possible. Sarah Mason provided outstanding typing services.

Expanded Contents

Preface xv
Acknowledgments xix

Part I Introduction

1	Scarcity, the Three Questions of Economics, and an Economic System	5	Applications of the Production Possibilities Frontier and Opportunity Cost	16
	Outline	5	Background	16
	Objectives	5	Reckoning with Opportunity Costs: The Case of the 55-mph Speed Limit	17
	The Three Fundamental Economic Questions	6	Opportunity Cost, Comparative Advantage, and Specialization	19
	A Thought Quiz	6	The Concept of a Market Economy and the Economy of the United States	21
	Understanding Economic Events with Economic Analysis	8	Summary and Conclusions	23
	An Example of Government Policy and Its Impact on the Answers to the Three Economic Questions: Medical Care	9	Key Terms	23
	Scarcity and an Economic System	10	Questions for Discussion and Review	23
	What Is an Economic Model?	10	Appendix <i>Economics and Your Career</i>	25
	An Introductory Example: Dealing with Scarcity in a Small Economy	11	Why Take Economics?	25
	The Production Possibilities Frontier (PPF)	11	Economics As a Major	25
	The Production Possibilities Frontier, Opportunity Cost, and Economic Efficiency	13	Careers in Economics	25
	The Shape of the Production Possibilities Frontier	14	Prominent Economics Majors and Positions They Have Held	26
			Policy Issue: You Decide <i>Who Should Pay for Clean Air?</i>	27
			The Action-Initiating Event	27
			The Issue	27
			Economic Policy Issues	27
			Recommendations	27

Part II

Introduction to Macroeconomics

2 Introduction to Macroeconomics 31

- Outline 31
- Objectives 31
- An Introduction to the Study of Macroeconomics 32
- GNP: A Measure of a Society's Total Production 33
 - Background 33
 - The Nominal Value of GNP 34
 - Consumption 34
 - Investment 35
 - Government Spending 36
 - Net Exports 37
 - GNP and Economic Well-being 37
 - The Role of Nonmarket Transactions 37
 - Leisure Time 38
 - Illegal Transactions and Barter 39
 - Intermediate Transactions 39
- GNP Is Also a Measure of a Society's Total Income 40
 - The Circular Flow of Income 40
 - Data on GNP as a Source of Income 40
- Other Measures of Production and National Income 42
 - Background 42
 - Calculating Real GNP 42
 - The Need for a Price Index 42
 - The CPI and GNP Deflator for the United States 44
 - Price Indexes and Inflation 45
 - Estimates of Real GNP for the United States and Changes in Real GNP 46

- Interest Rates 47
 - Real versus Nominal Rates of Interest 48
 - Real versus Nominal Interest Rates in Recent Years 49
- Unemployment 49
 - Definition and Measure of Unemployment 49
 - Why Is Unemployment Such an Important Economic Issue? 50
- Summary and Conclusions 51
- Key Terms 51
- Questions for Discussion and Review 52
- Appendix *Introduction to Supply and Demand* 53
 - The Demand Relationship 53
 - Basic Assumptions of Demand 53
 - The Goals of Buyers and How They Attempt to Achieve Them 54
 - Limitations on Choices Buyers Can Make 54
 - Method of Analysis 55
 - The Law of Demand and the Demand Curve 55
 - Shifts in Demand 56
 - The Supply Relationship 58
 - Basic Assumptions of Supply Theory 58
 - Suppliers and Their Goals 59
 - The Law of Supply 59
 - Method of Analysis 59
 - Factors that Shift Supply 60
 - Changes in Technology 60
 - Changes in Input Prices 61
 - Changes in Expected Future Prices 61
- How the Forces of Supply and Demand Determine Price and the Level of Production 61
 - The Concept of Equilibrium 62
 - The Effects of Shifts in Supply and Demand on Equilibrium Price and Quantity 62
- Key Terms 63

3 Employment, Unemployment, and the Aggregate Production of Goods and Services 65

Outline 65

Objectives 65

Introduction 66

The Labor Market 67

 The Demand for Labor 67

 The Value of Labor's Marginal Product Is a Firm's Labor Demand Curve 68

 A Firm's Demand for Labor, Its Production Function, and Its Total Output 72

 The Aggregate Demand for Labor 72

 The Supply of Labor 74

 Factors Underlying an Individual's Labor Supply Decision 74

 The Aggregate Supply of Labor 75

 The Aggregate Labor Market and the Aggregate Quantity of Goods and Services Supplied 76

 Expectations 76

 Equilibrium in the Aggregate Labor Market 76

Unemployment 78

 What Is Unemployment? 78

 Varieties of Unemployment and Their Causes 78

 Frictional Unemployment 78

 Structural Unemployment 80

 Cyclical Unemployment 81

Summary and Conclusions 85

Key Terms 86

Questions for Discussion and Review 86

4 Aggregate Expenditure on Goods and Services 89

Outline 89

Objectives 89

Introduction 90

Aggregate Expenditure on Goods and Services:

 Background 91

 The Components of Aggregate Expenditure: A Brief Review 91

 GNP Also Measures Society's Total Income 91

 A Brief Review 91

 The Uses of Society's Total Income 91

 An Analysis of Aggregate Expenditure on Goods and Services 92

 The Consumption Function 93

 The Consumption Function Expressed Quantitatively 93

 The Consumption Function Expressed Graphically 96

 Investment 97

 Government Spending and Net Exports 100

 Aggregate Expenditure, Aggregate Production, and Equilibrium GNP 101

 Another Look at Equilibrium GNP: Saving, Investment, and the Government Deficit 103

 The National Income Accounts: Measured Saving, Measured Investment, the Government Deficit, and Measured GNP 108

Summary and Conclusions 109

Key Terms 109

Questions for Discussion and Review 109

Appendix A *Deeper Look at the Multiplier and Graphical Analysis* 110

5 Money and the Banking System 115

- Outline 115
- Objectives 115
- Introduction 116
- The Role of Money 117
 - Money as a Medium of Exchange 117
 - The Advantage of a Monetary Economy Over a Barter Economy 117
 - Money as a Unit of Account 117
 - Money as a Store of Value 118
 - Monetary Standards and the Value of Money 119
- The Banking System and Money 120
- The Balance Sheet of a Bank 121
- How Banks Create Money 122
 - Cash Drain and Multiple Deposit Expansion 125
- The Consolidated Balance Sheet of the Banking System 126
- The Definitions of Money in the United States Economy 127
 - Are Credit Cards Money? 128
- Summary and Conclusions 129
- Key Terms 129
- Questions for Discussion and Review 129

6 The Central Bank and Regulation of Money and the Banking System 131

- Outline 131
- Objectives 131
- Introduction 132
- Keeping Money Scarce: The Role of the Fed 133
 - The Balance Sheet of the Fed and the Banking System 134
- The Means of Monetary Control: The Instruments of Monetary Policy 134
 - Open Market Operations and the Quantity of Money with No Currency Drain 135
 - Other Instruments of Monetary Policy 139
- Preview: The Linkage between Money, Credit, and National Income 143
- Summary and Conclusions 145
- Key Terms 146
- Questions for Discussion and Review 146

7 Money, Credit, and the Rate of Interest 149

- Outline 149
- Objectives 149
- Introduction 150
 - Things to Come 150
 - Financial Instruments 151
 - The Decision to Hold Money versus Loan Contracts 152
- The Loan Contract Market 152
 - Background 152
 - A Closer Look at the Details of a Loan Contract 152
 - The Model of the Loan Contract Market to Be Developed 153
 - The Demand for Loanable Funds 153
 - Firms 153
 - The Government 155
 - The Aggregate Demand Curve for Loanable Funds and the Rate of Interest 156
 - The Supply of Loanable Funds 157
 - Households as Suppliers of Loanable Funds 157
 - Banks as Suppliers of Funds 159
 - The Aggregate Supply of Loanable Funds 162
 - Equilibrium in the Loan Contract Market 162
 - The Determination of the Real Interest Rate 162
 - The Structure of Interest Rates 164
- Summary and Conclusions 165
- Key Terms 166
- Questions for Discussion and Review 166
- Policy Issue: You Decide *Deregulation of the Banking Industry* 167
- The Action–Initiating Event 167
- The Issue 167
- Economic Policy Issues 167
- Recommendations 167

Part III

Macroeconomic Policy

- 8 How the Macroeconomy Works 171
 - Outline 171
 - Objectives 171
 - Introduction 172
 - Full Macroeconomic Equilibrium: Satisfying Three Markets Simultaneously 173
 - A Closer Look at Full Macroeconomic Equilibrium 175
 - Recessions and Inflationary Episodes 178
 - Recession: The Effect of a Decline in Planned Investment 178
 - A Leftward Shift in the Demand for Loanable Funds 179
 - A Decline in the Interest Rate 179
 - Reaction in the Goods and Labor Markets 181
 - A Decline in Saving: Short-Run Macroeconomic Equilibrium in a Recession 182
 - Adjustment toward Full Macroeconomic Equilibrium with Flexible Prices 182
 - Recapitulation 184
 - An Inflationary Episode Resulting from an Increase in Planned Investment 185
 - Summary and Conclusions 187
 - Key Terms 188
 - Questions for Discussion and Review 188
- 9 Aggregate Demand, Aggregate Supply, and the Price Level 189
 - Outline 189
 - Objectives 189
 - Introduction 190
 - The Equilibrium Price Level: The Quantity Theory 191
 - The Role of Velocity 194
 - Summarizing Changes in Aggregate Production and the Price Level: Aggregate Demand and Supply 195
 - Aggregate Demand 196
 - Aggregate Supply 197
 - Equilibrium of Aggregate Demand and Supply 197
 - Aggregate Demand and Supply during a Recession 197
 - Aggregate Demand and Supply during an Inflationary Episode 201
 - Macroequilibrium, Recession, and Inflation in a Growth Scenario 204
 - A Brief Historical Note 206
 - The Rate of Inflation and Unemployment during Recessions and Inflationary Episodes 206
 - Can Workers or Other Suppliers Cause Inflation? 208
 - Summary and Conclusions 211
 - Key Terms 212
 - Questions for Discussion and Review 212
- 10 Fiscal and Monetary Policies 213
 - Outline 213
 - Objectives 213
 - Introduction 214
 - Discretionary Fiscal Policy in a Recession 216
 - Response of the Fiscal Authority to a Decline in Investment Demand: An Increase in Expenditure 216
 - Reaction in the Goods Market 216
 - Reaction in the Credit Market 216
 - Why Fiscal Policy Works 218
 - Discretionary Fiscal Policy When Taxes Are Adjusted 218
 - Discretionary Fiscal Policy to Prevent an Inflationary Episode 221
 - Lags, Politics, and Fiscal Policy 222
 - Nondiscretionary Fiscal Policy 223
 - Recent Fiscal Policy Developments 223
 - Discretionary Monetary Policy in a Recession 224
 - The Initial Effect in the Loanable Funds Market 226
 - The Effect in the Goods Market 226
 - Why Monetary Policy Works 226
 - Discretionary Monetary Policy to Prevent Inflation 227
 - The Politics of Discretionary Antiinflation Monetary Policy 228
 - Comparing the Short-run and Long-run Effects of Fiscal and Monetary Policies 229
 - Is Discretionary Policy Useless? 229
 - Summary and Conclusions 230
 - Key Terms 230
 - Questions for Discussion and Review 231

11 Monetary and Fiscal Policies in Action 233

- Outline 233
- Objectives 233
- Introduction 234
- The Great Depression 234
 - The United States Economy in 1929 and 1930 234
 - Appropriate Fiscal and Monetary Policies in 1930 235
 - Actual Fiscal and Monetary Policies in 1930 236
 - The United States Economy in 1931 and 1932 236
 - Monetary and Fiscal Policies in 1931 236
 - Monetary Policy in 1932 237
- The Great Inflation: 1965–? 237
 - The Economic Setting in Late 1965 and Early 1966 237
 - The War and Increased Government Expenditure 239
 - How Monetary Policy Could Have Prevented Inflation 239
 - Monetary Policy in 1965 and 1966 240
 - The Reversal of the Fed's Monetary Policy 240
 - The Effects of the Fed's Expansionary Monetary Policy 241
 - Stagflation: The United States Economy in the 1970s and Early 1980s 241
 - Money Growth, Inflation, and Unemployment 241
 - Money Growth, Inflation, and the Interest Rate 247
- Summary and Conclusions 248
- Questions for Discussion and Review 249

12 Summing Up: Macroeconomic Controversies 251

- Outline 251
- Objectives 251
- Introduction 252
 - Areas of Agreement and Disagreement among Economists 252
 - Controversies over Short-run Macroeconomic Policy: Is Fine-tuning Practical? 253
 - Monetarism and Keynesianism 253
 - Different Views of How the Economy Works 253
 - Keynesian and Monetarist Views about How Monetary Policy Affects the Economy 253
 - Monetarist and Keynesian Explanations for the Recession of the Early 1980s and Continued High Interest Rates through 1985 254
 - Keynesian and Monetarist Differences of Opinion about the Need to Try to Control the Macroeconomy and the Ability to Do So 255
 - Differences in Keynesian and Monetarist Policy Recommendations 256
 - Long-run Considerations and the “Supply Side” 257
 - Supply-side Economics 257
 - The Laffer Curve 257
 - Supply-side, Keynesian, and Monetarist Views of Government Spending Cuts during a Recession 258
 - The Government Deficit: Does It Matter? 258
 - Deficits and Presidential Politics 259
 - The Sources of United States Deficits in the 1980s 260
 - The Recent Debt Experience of Industrialized Nations 262
 - The Economic Significance of the Debt 262
 - Deficits and Business Cycles 262
 - Structural Deficits 263
 - “Crowding Out”: The Short-run and Long-run Effects of the Deficit 264
- Summary and Conclusions 266
- Key Terms 267
- Questions for Discussion and Review 267
- Policy Issue: You Decide *Flat Tax* 268
- The Action-Initiating Event 268
- The Issue 268
- Economic Policy Issues 268
- Recommendations 268

Part IV

The International Economy

- | | |
|---|---|
| <p>13 Trade among Nations 273</p> <p>Outline 273</p> <p>Objectives 273</p> <p>Introduction 274</p> <p>Import and Export Patterns in the United States</p> <p> Economy and the World Economy 275</p> <p>Imports, Exports, and the Gains from Trade 279</p> <p> The Supply and Demand for Imports and Exports 279</p> <p> The Effect of the World Price on Domestic Production and Consumption 280</p> <p> The Equilibrium World Price and the Flow of Trade 282</p> <p> Supply, Demand, and International Trade Patterns 285</p> <p>Winners and Losers: The Distribution of the Gains from Trade 286</p> <p> Winners and Losers in the Importing Country 286</p> <p> Winners and Losers in the Exporting Country 289</p> <p>Summary and Conclusions 290</p> <p>Key Terms 291</p> <p>Questions for Discussion and Review 291</p> | <p>14 The Regulation of International Trade 293</p> <p>Outline 293</p> <p>Objectives 293</p> <p>Introduction 294</p> <p>Why Interfere with a Good Thing? 295</p> <p> Internal Taxes as Substitutes for Tariffs: British and United States Experiences 295</p> <p> Income Distribution Considerations 295</p> <p> Strategic Goods and Infant Industries: Bases for Import Barriers? 296</p> <p> Strategic Supplies of Steel 297</p> <p> Infant Industries and Technology Transfers 297</p> <p> Import Substitution 298</p> <p>Barriers to International Trade 298</p> <p> Tariffs 299</p> <p> United States Tariff History 299</p> <p> A Tariff on Steel Imports from Japan 300</p> <p> Aggregate Economic Losses 301</p> <p> Specific Duties versus ad Valorem Tariffs 302</p> <p>Quotas and Other Nontariff Trade Barriers (NTBs) 303</p> <p> Revenue Needs and the Shift to NTBs 304</p> <p> NTBs and the Tariff Revenue Equivalent 304</p> <p> “Voluntary” Quotas 304</p> <p>The General Agreement on Tariffs and Trade (GATT), “Fair” Competition, and Trade Restrictions 306</p> <p> The Rules of the Game and “Unfair” Trade Practices 306</p> <p> The Trade Expansion Act of 1962 307</p> <p> Customs Unions 308</p> <p>Summary and Conclusions 310</p> <p>Key Terms 311</p> <p>Questions for Discussion and Review 311</p> |
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