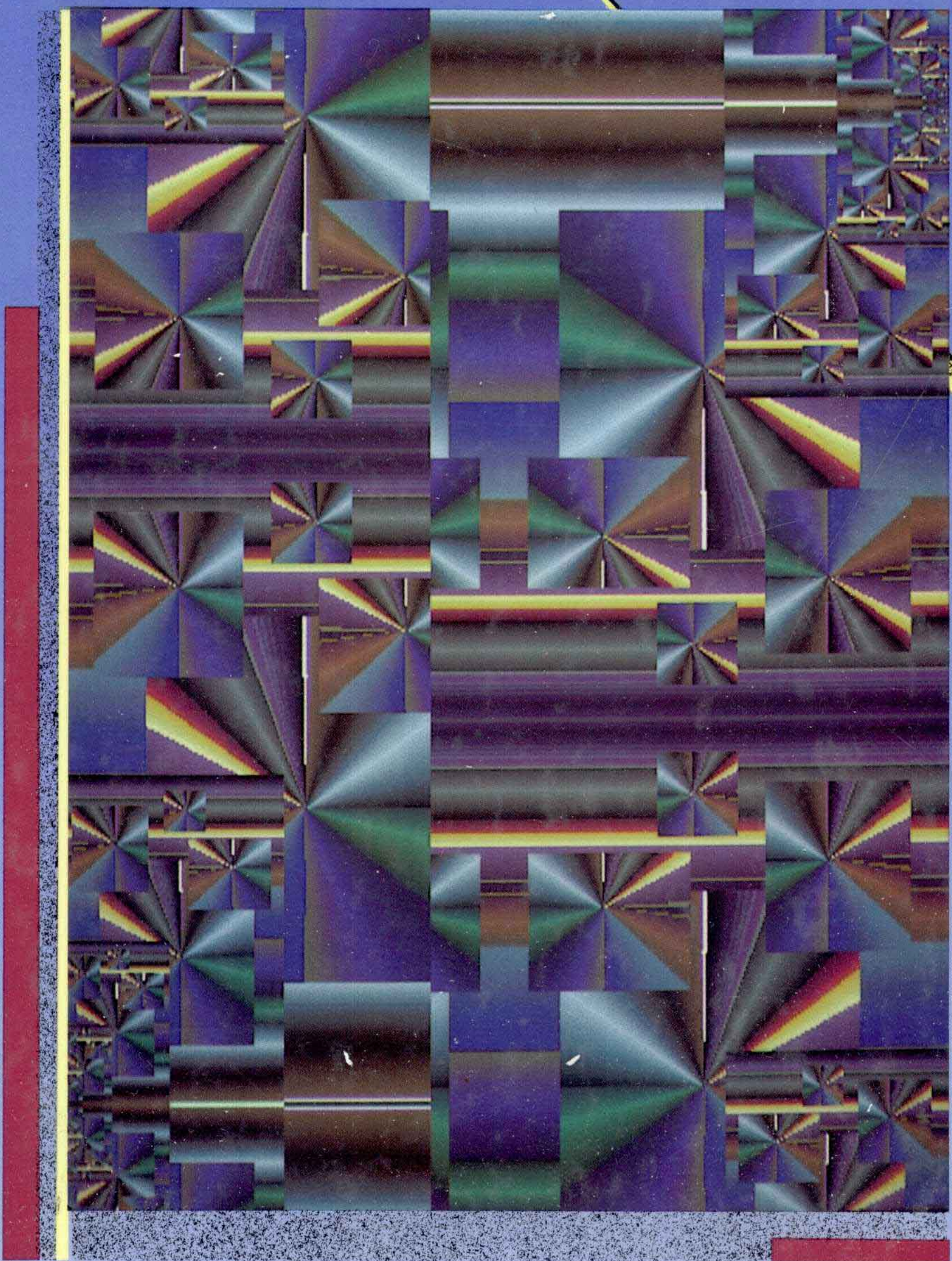
ROBERT J. BARRO

MACROECONOMICS



THIRD EDITION

MACROECONOMICS

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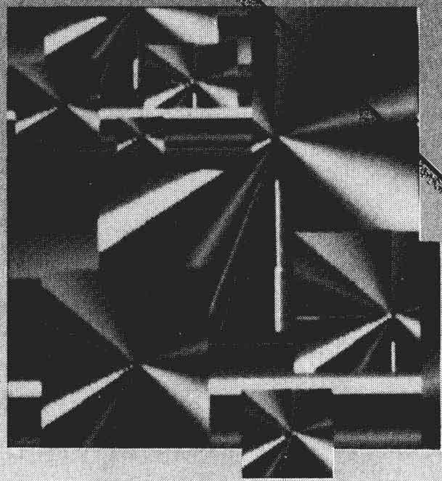

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PREFACE

Macroeconomics is in a state of flux. The Keynesian model, which was almost universally accepted as the basic paradigm until the late 1960s, has become increasingly less popular. This loss in popularity reflects embarrassments over past economic events, especially the failure of the model to deal satisfactorily with inflation and supply shocks. It also reflects the theoretical and empirical progress of an alternative "market-clearing approach," which is more closely related to the microeconomics that economists use successfully to study the behavior of individual households and businesses. Although some important problems remain, this approach provides a much more satisfactory macroeconomics than the one we had before. By more satisfactory, I mean that the approach avoids internal inconsistencies and also provides a better understanding of the real world.

Although the Keynesian model has been subject to increasing skepticism by economists, it has nevertheless continued to reign supreme in most textbooks. As a result, it has continued to organize the way the subject has been taught to the majority of students. Many textbooks present aspects of market-clearing models but these models have not been taken seriously in the study of real-world events or policy proposals. This gap between textbook material and the knowledge gained in the last 20 years motivated me to write the first edition of this book.

My purpose is to present the market-clearing approach as a general method for analyzing real-world macroeconomic problems. The stress on this approach means that the book is not a "balanced" treatment of alternative macroeconomic models. There is no book—and probably could be none of substance—that is balanced in this respect. Although I deal in a serious manner with the Keynesian model—and show carefully how it relates to the market-clearing approach—I do not use the Keynesian framework for most of the analyses of economic events or policies. In any case, whatever one's ultimate judgment about the value of the Keynesian model, there is a very good reason not to begin the study of macroeconomics with it. The Keynesian theory is an advanced topic that makes specific assumptions about the ways that private markets malfunction. The nature of these malfunctions and the special features of the Keynesian model cannot be fully understood and appreciated until the market-clearing analysis has been worked out.

I have been very encouraged by the market's reception of previous editions. This favorable reception shows up directly in the large and growing usage of the book in undergraduate courses at many colleges. The book has also received a lot of attention in the national press. Positive reviews appeared in *Newsweek*, *Fortune*, the *Wall Street Journal*, *Newsday*, the *Boston Globe*, the *Washington Times*, the

Rochester Democrat and Chronicle, and the *Financial Times*. Reviews of textbooks in the media are rare, and these were a pleasant surprise to me (and my publisher).

I think that the favorable reception reflects the widespread eagerness for a macroeconomic framework that outperforms the Keynesian model. Although the Keynesian model can be appealing as a teaching device, it tends to leave students with a poor understanding of how the economy works and how governmental policies can help—or hinder—it. In addition, I have found that many instructors have become convinced, after some initial skepticism, that the more satisfactory market-clearing approach really is accessible to undergraduates.

This third edition maintains the theme of previous editions but makes a number of improvements. The most important is the expanded treatment of the international economy. Partly because of the concern over recent economic events—such as the U.S. current-account deficit, the fluctuations of exchange rates, and the international debt crisis—most teachers of intermediate macroeconomics now desire to include a substantial discussion of the world economy. Chapters 15 and 16 (which significantly extend the previous Chapter 20) are new; they show how the market-clearing approach with stress on intertemporal considerations applies readily to international topics. The coverage includes international borrowing and lending, the current-account balance, shifts in the terms of trade, flexible and fixed exchange rates (including the gold standard and the European Monetary System), and the recent behavior of real exchange rates. A new section explores the role of fiscal policy in the world economy, with stress on the linkage between budget and current-account deficits.

Another addition worth highlighting is the discussion in Chapter 19 of rules versus discretion in the government's policy choices. This section discusses an application of game-theoretic reasoning to the study of policy formation. The analysis shows why monetary growth and inflation tend to be excessive, why credible rules can improve outcomes, and why such rules are difficult to enforce. This discussion approaches the frontiers of macroeconomic research by dealing with recent discoveries that have already proved to be of great importance for policy evaluation. Fortunately the key points can be explained in a way that is comprehensible for undergraduates.

As with previous editions, I discuss the material in as simple a fashion as I have found possible so that the book can be used for undergraduate courses in intermediate macroeconomics. Six years of experience have demonstrated that the book works well for these courses. However, the feedback from users has helped me to simplify the exposition in many places. Therefore, I am confident that students will find this third edition even more accessible than the earlier ones.

In writing this book, I have benefited from an unusual amount of excellent advice, as well as encouragement to carry out the project. Since regular revision is a part of textbook writing, I appreciate suggestions from readers. I am particularly grateful to Mark Rush, who provided valuable and detailed comments on several versions of all three editions. I also acknowledge the helpful comments of Ken Chapman, Marty Eichenbaum, Mark Fisher, Roger Goldberg, John Haltiwanger, Barry Ickes, Jim Kahn, Evan Koenig, Prakash Loungani, and James McGibbany.

Robert Barro

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