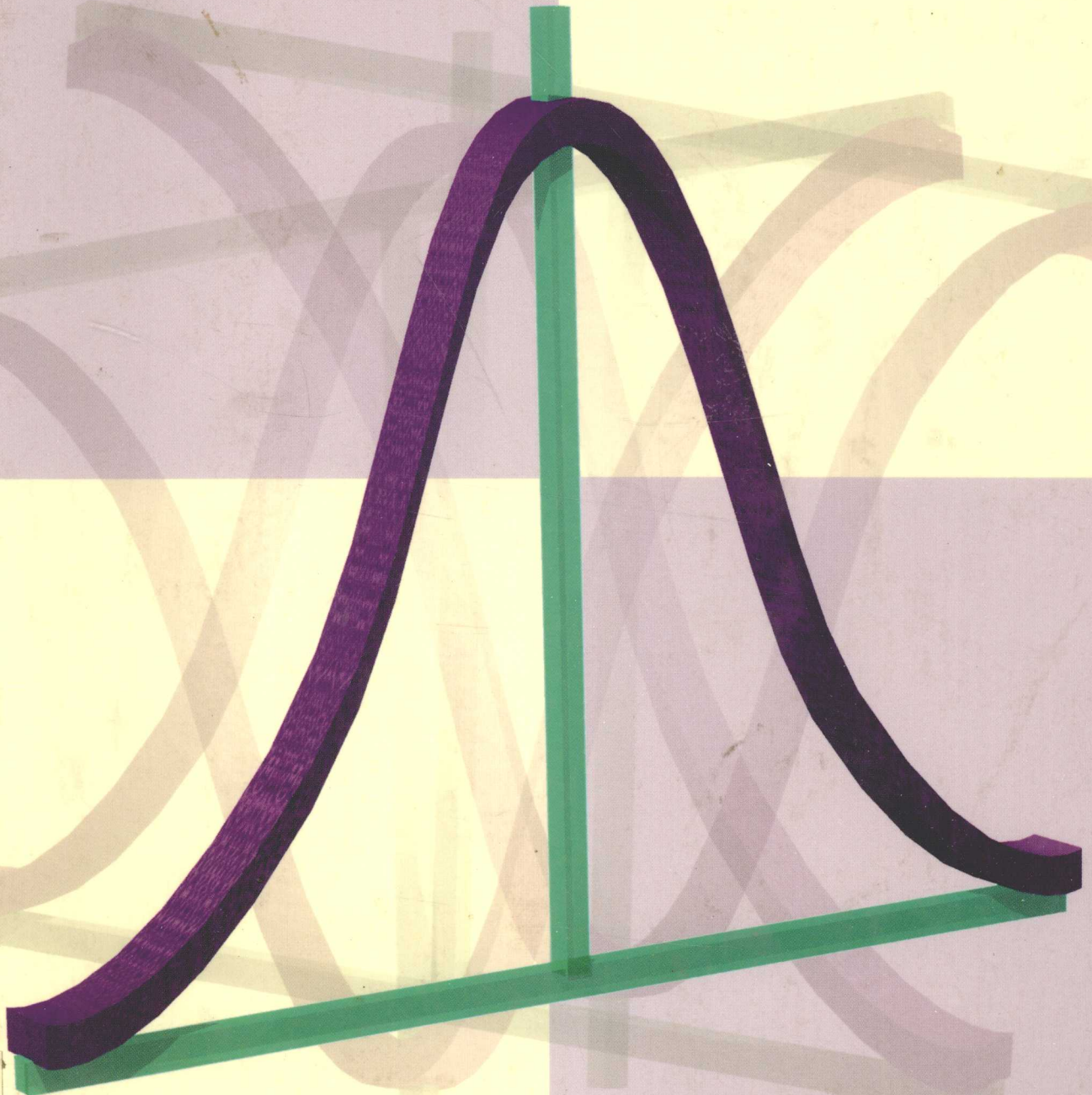


FIFTH EDITION

MACROECONOMICS

Private Markets and Public Choice



EKELUND • TOLLISON

Fifth Edition

MACROECONOMICS

Private Markets and Public Choice

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MACROECONOMICS

Private Markets and Public Choice

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For My Mother, Anna Mae Ekelund

RBE

For Willa and Joe

RDT

PREFACE

Economic issues dominate the world we live in, affecting our perceptions about ourselves and our futures. Like it or not, we are faced with economic issues on television, in newspapers, in the voting booth, in career choice, and, perhaps most significantly, in balancing our checkbooks every month! Will persistent federal deficits and more than \$5 trillion of debt saddle future generations, and very possibly ourselves, with high taxes, slow growth, and stagnation? Put another way, can we expect the children of our generation to be better off than our generation or that of our parents? Do federally guaranteed entitlements—such as Medicare, Social Security, and welfare—have a future? Will international trade agreements, such as the North American Free Trade Association (NAFTA) or the General Agreement on Tariffs and Trade (GATT), have a positive or negative impact on the economic well-being of Americans? Should government play a large, small, or negligible role in providing the groceries we buy in the store or in the health insurance we buy every year?

A solid foundation in economics helps us answer such questions. In this fifth edition of our introduction to macroeconomics, we again present economic ideas in a policy-real-world context that students—both those who continue the study of economics and those for whom this is the first and last class—can master and understand. Since our approach stresses the relationship between theory and policy, the technical presentations in this book are concise and straightforward. We rely heavily on examples to illustrate abstract theory, and describe graphs and graphical relationships in patient detail.

Our approach to economic study is “market oriented.” It stresses that, in general, society’s welfare is maximized when markets are used to allocate resources to their most desired private uses. Our approach goes further, however, to show (as early as the first chapters) how our public choices working through a political process can have a number of effects, not all of them desirable from the perspective of society. Democratic politics (as we make clear in Chapter 4) and interest groups may actually reduce society’s welfare. In short, our approach to basic macroeconomics is underscored by the integration of politics and markets—and by the new subtitle to the fifth edition of *Macroeconomics: Private Markets and Public Choice*. The fifth edition again covers macroeconomics in clear and student-friendly prose with:

- Renewed emphasis on the use of markets to solve the basic economic problems created by scarcity;

- New and interesting examples of how economic and political markets interact and affect economic efficiency;
- Coverage of recent and continuing global events, particularly those that have created new “free-trade” alliances between the United States and other nations of the world;
- Clear analysis of important domestic policies and proposals relating to such issues as tax reform, deficits, the mega-debt, and monetary policy.
- Targeted, but streamlined discussions of theory and policy in a shorter presentation than the fourth edition.

New to the Fifth Edition

The fifth edition of *Macroeconomics* contains many changes, including new topics, examples, and applications. While structural changes requiring a fundamental revision of instructor's lectures and assignments have been held to a minimum, there are some important differences from the fourth edition, in addition to those listed above.

The public choice theme (present in all previous editions) has been clarified and expanded. In spite of the supposed public choice emphasis of other texts, we have found that the critical issue of how politics affects markets is not integrated into discussions of standard economic issues. In addition to a new Chapter 4 dealing with public choice, we provide in-text and “application-style” examples integrating public choice with discussion of basic economic issues. Thus, the student is introduced to issues such as why joining a health club is different from being a member of the student government at a university (Chapter 3) and how peanut and auto quotas are related to politics (Chapter 16).

There is renewed emphasis on the importance of all trade, including international trade. The principles of specialization, opportunity cost, and trade run throughout the book and are explicitly introduced to the student in Chapter 2, which explains the role of free trade associations such as NAFTA in producing greater economic welfare and integrates international trade and interest group considerations right from the beginning. The emphasis on the importance of international trade and markets is carried throughout the text. See, for example, discussions of how the macroeconomy is related to international trade in Chapter 10, the discussions of international counterfeiting or monetary control institutions in Chapter 12, and the new discussions of property rights arrangements and their relation to growth in China, Korea, and other nations in Chapter 14.

Organization

Our presentation is provided in five parts:

Part One—The Power of Economic Thinking

Part Two—The Fundamentals of Macroeconomics

Part Three—Money

Part Four—Macroeconomic Policy and Economic Growth

Part Five—The Global Economy

We have found that many books attempting to provide an “orderly” and simple presentation of macroeconomic theory actually do the opposite. Students taking the “macro half” of principles of economics who are barely conversant with supply and demand are overwhelmed by “three-sector equilibrium” models of macroeconomic theory with short-run/long-run aggregate supply distinctions. We take a different approach—one that presents a smooth, logical, and historical transition from classical economics (Chapter 7) to Keynesian economics (Chapter 8) to aggregate demand and supply (Chapter 9). Our remaining chapters in macroeconomics then develop macroeconomic and monetary policies in the context of this progression (Chapters 10–13). This logical approach permits instructors to spend as much time emphasizing their own views of “key issues” while maintaining an orderly approach to macroeconomic theory. Those wishing to elongate the discussion of macroeconomic policies and their relation to U.S. and global growth may then go on to Chapters 14 and 15.

Two major alterations have been made in our structuring of macroeconomics. The first is that Keynesian economics, which was developed in two chapters in previous editions (Chapters 23 and 24 in the fourth edition), is now streamlined to one chapter (Chapter 8). We find this treatment—and the treatment of classical macro principles—to be logical and pedagogically sound. Most texts “hide” the nature of Keynes’s contribution, giving Keynes and his “rejection” of the classical ideas short shrift. Keynes thus appears as a minor figure; in fact, his ideas were the most important source of the “debate” that rages within macroeconomic theory and policy—the question of whether “activist” or “non-activist” policies have the greatest effect on overall growth of GDP in the United States or internationally. We assert that the source of these ideas continues to rest upon a sound understanding of both classical and Keynesian ideas and believe our in-depth treatments (in Chapters 7 and 8) promote this understanding.

A second major change in our presentation of macroeconomics is that we have streamlined an over-long basic money, banking, and Federal Reserve discussion from two chapters (Chapters 28 and 29 of the fourth edition) to one chapter (Chapter 12). Moreover, Chapter 32 on business cycles in the fourth edition has been eliminated, and the most relevant and interesting materials from that chapter are now included in other chapter discussions.

Part Five—The Global Economy, includes Chapters 16 and 17, which are devoted to issues relating to international trade and finance. A number of instructors have told us that they prefer to teach these issues as a special unit or topic. These chapters have been streamlined and completely updated for that purpose. However, international trade issues and their relation to our economy and well-being are an integral part of our entire book. Our view is that these issues are not separate from trade issues in general. We therefore begin, in Chapter 2, with matters of specialization, comparative advantage, and trade from an international perspective. These ideas and applications are then carried throughout the book.

Features of the Fifth Edition

We have designed the fifth edition of *Macroeconomics* solely with the learning objectives of the student-reader in mind. The most successful pedagogical features

of all earlier editions have been maintained and several innovative ideas have been added. Each chapter opens with an overview of the topics covered and a bulleted list of chapter objectives.

- Figures are drawn with consistent use of color, helping students understand key concepts and the direction and magnitude of changes in economic behavior.
- Key concepts and terms are boldfaced when first mentioned in the text, with definitions appearing in the margin.
- Reader-friendly Focus boxes—at least one per chapter—provide interpretations and perspectives on critical or illustrative ideas or policies mentioned in the text. Many of the Focus features are new to the fifth edition. Examples include: “Scarcity, Economizing, and the College Student’s Time” (Chapter 1); “Is Student Government Different from Joining a Health Club?” (Chapter 4); “Do Politicians Create Ups and Downs in the Business Cycle?” (Chapter 5); “How the Political System Helps Create Deficits” (Chapter 8); “Did Keynesian Economics and World War II Save Us From the Depression?” (Chapter 10); “Can a Pub Become a Bank? The Modern Case of Ireland” (Chapter 12); and “Counterfeiting and the Quantity Theory of Money” (Chapter 13).
- Applications of key text material are again included in our presentation. These are in-depth discussions of issues or policies brought up in the text. Many of these features are new to the fifth edition. A sample includes: “When a Rose is Not a Rose: Interest Groups and Shifting Comparative Advantage in the Flower Industry” (Chapter 2); “Why Are There So Many Restaurants and Golf Courses in State Capital Cities?” (Chapter 4); “Beating the IRS: How Big is the Underground Economy?” (Chapter 6); “Mortgaging Your Future: The Government and Your Incentive to Save” (Chapter 8); “The Impact of Freer Trade on the Macroeconomy” (Chapter 10); “Moral Hazard and the Savings and Loan Crisis” (Chapter 12); “Politics and Inflation: A Global Perspective” (Chapter 13); and “NAFTA: Free Trade or Free-For-All?” (Chapter 16).
- Every chapter contains a concluding summary of the major ideas and concepts of the chapter, a list of key terms, questions for review and discussion, and, where applicable, problems for the student to solve.
- Point/Counterpoint features containing biographies of great economists, past and present, along with their contrasting ideas, conclude each book part.
- A glossary of terms, including text page references, is provided at the back of the book, together with a useful and thorough index.

PRINT SUPPLEMENTS

The *Study Guide* by John Keith Watson of the University of Southwestern Louisiana is a comprehensive learning package containing chapter overviews; learning objectives; helpful hints; fill-in, true/false, multiple-choice, and short-answer questions, and “Something to Think About” segments.

The *Instructor’s Resource Manual* by John Keith Watson of the University of Southwestern Louisiana is coordinated with the text and contains chapter over-

views and outlines, learning objectives, answers to text questions, extra problems and essays with solutions, “One Step Further” segments and suggestions for additional readings.

The *Test Bank* by Frank Mixon of the University of Southern Mississippi contains over 3,400 multiple-choice questions coded by level of difficulty. Ten percent of the questions are new to this edition and are identified with a margin icon.

Color acetates of main figures and tables in the text are also available.

SOFTWARE SUPPLEMENTS

For the Student

Economics Tutor by Daniel K. Benjamin of Clemson University is a Windows-compatible DOS tutorial program with three distinct features. First, it employs a graphical user interface that can be driven by either a mouse or a keyboard. Second, it goes beyond the conventional “textbook on a screen” approach by involving the student in a fully interactive way. Finally, the program’s architecture recognizes that students who enjoy what they are doing are likely to do more of it, so *Economics Tutor* brings the “feel” of computer games into a college-level economics tutorial program for the first time.

For the Instructor

TestMaster, a computerized test generator that allows you to construct tests by choosing questions from the test bank, is available in IBM and Windows versions. If desired, test questions can be viewed on the screen, edited, saved, and printed. Instructors can also add or create their own questions. A *TestMaster User’s Guide* provides comprehensive instructions.

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