

Fourth Edition Macroeconomics

A Contemporary Introduction



William A. McEachern

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F o u r t h E d n

Macroeconomics

A Contemporary Introduction

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ABOUT THE COVER DESIGN

The cover illustrates "Networking Around Earth," a painting by Alan Cober. The image demonstrates many concepts at once—global economic growth, the rise of information technology, the interconnectedness of local cultures and economies. Similarly, the new edition of *Macroeconomics: A Contemporary Introduction* integrates in every chapter international economic issues, real-world examples, and today's most promising new information technology, the Internet. Copyright © Alan Cober/515.

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To Pat

Preface

Economics has a short history but a long past. As a distinct discipline, economics has been studied for only a few hundred years, yet civilizations have confronted the economic problem of scarce resources but unlimited wants for millenia. Economics, the discipline, may be centuries old, but it is new every day. Each day offers fresh evidence to support or reshape evolving economic theory. In *Economics: A Contemporary Introduction*, I draw upon my 25 years of teaching principles to convey the vitality, timeliness, and evolving nature of economics.

Remember the last time you were in an unfamiliar neighborhood and had to ask for directions? Along with the directions came the standard comment “You can’t miss it!” So how come you missed it? Because the “landmark” that was obvious to the neighborhood resident who gave the directions might as well have been invisible to you, a stranger. Writing a principles text is much like giving directions. The author must be familiar with the material, but familiarity can also dull one’s perceptions, making it difficult to see things through the fresh eyes of a principles student. Some authors try to compensate by telling all they know, in the process overwhelming the student with so much detail that the central point gets lost. Other authors take a minimalist approach by offering little of what students may already know intuitively, and instead talking abstractly about good x and good y , units of labor and units of capital, or the proverbial widget. This turns economics into a foreign language.

Students typically arrive the first day of class with 18 or more years of experience with economic institutions, economic events, and economic choices. Each student grew up in a household—the central economic institution. As consumers, students are familiar with fast-food restaurants, movie theaters, car dealers, and dozens of stores at the mall. Most students have been resource suppliers—more than half held jobs while in high school. Students also have

experienced government: For example, they know about sales taxes, drivers licenses, speed limits, and public education. And, from imported cars to emerging markets around the globe, students are growing more aware of the rest of the world.

Thus, students have abundant experience with economic institutions, economic events, and economic choices. They may not recognize the economic content of this experience, but they possess this knowledge nonetheless. Yet some principles authors neglect this rich lode of student experience, and instead try to create for the student a new world of economics. Such an approach fails to make the connection between economics and what Alfred Marshall called “the ordinary business of life.”

Good directions rely on landmarks familiar to us all—a stoplight, a fork in the road, a white picket fence. Likewise, a good textbook builds bridges from the familiar to the new. I try to build such bridges. How? *In essence, I try to “lead by example”—I provide examples that draw on the students’ common experience.* I try to create graphic pictures that need little explanation, thereby eliciting from the reader that light of recognition, that “Aha!”. Examples should be self-explanatory; they should convey the point quickly and directly. Having to explain an example is like having to explain a joke—the point gets lost. Throughout, I provide just enough intuitive information and institutional detail to get the point across without overwhelming the student. My emphasis is on economic ideas, not economic jargon.

Since instructors can cover only a fraction of the textbook material in class, principles texts should, to the extent possible, be self-explanatory, thereby providing instructors with greater flexibility to emphasize topics of special interest. My approach is to start where students are, not where we would like them to be. For example, to explain the division of labor, rather than refer to Adam Smith’s pin factory, I call attention to the division of labor at McDonald’s. To

explain resource substitution, rather than referring to abstract units of labor and capital, I discuss a specific example, such as labor-capital combinations for washing a car—ranging from a drive-through car wash (much capital and little labor) to a Saturday-morning-send-the-band-to-Disney-World-charity car wash (little capital and much labor).

THE FOURTH EDITION

Introductory Chapters. Topics common to both macroeconomics and microeconomics are covered in the first four chapters. Limiting the introductory material to four chapters saves precious class time, particularly at institutions where students can take macro and micro courses in either order (and hence are likely to end up repeating the introductory chapters). New case studies in the introductory chapters aim to draw students into the material and include discussions of marginal analysis in the computer industry, the market for professional basketball, specialization on the Internet, and the global market for automobiles.

Macroeconomic Chapters. Since there is no consensus about which macroeconomic model explains the economy best, some textbooks present a smorgasbord of alternative macroeconomic approaches, leaving it to the student to choose among them. Students, however, lack sufficient background to evaluate the alternatives, so competing theories often seem unrelated and confusing. Rather than dwell on the differences among competing schools of thought, I use the aggregate demand and aggregate supply model to focus on the fundamental distinction between the *active approach*, which views the economy as essentially stable and self-correcting, and the *passive approach*, which views the economy as unstable and in need of government intervention.

Wherever possible, I rely on the students' experience and intuition to explain the theory behind macroeconomic abstractions such as aggregate demand and aggregate supply. For example, to explain how employment can temporarily exceed its natural rate, I note how students, as the term draws to a close, can temporarily shift into high gear to study for final exams and finish term papers. I have made the graphs more readable and more intuitively obvious by using

numbers rather than letters. And to convey a feel for the size of the U.S. economy, I usually list trillions of dollars rather than billions of dollars. For example, students have an easier time grasping a change in real GDP expressed as an increase from \$7.0 trillion to \$7.2 trillion rather than as an increase from Y to Y' . This edition measures real output in chained (1992) dollars, reflecting the most recent revisions by the Bureau of Economic Analysis.

In light of the renewed interest in economic growth, I have moved up the chapter on economic growth to follow the introductory macroeconomic chapter. Emerging issues of macroeconomics that receive coverage in this edition include “green” accounting, coordination failures, real business cycle theory, asymmetric information in banking, and the convergence of national economies. Some other timely issues discussed in case studies include counterfeiting, computer banking, growth rates around the world, hysteresis and high unemployment in Europe, industrial policy, balancing the federal budget, computers and GDP growth, and the link between central bank independence and inflation around the world.

International Chapters. This revision reflects the growing impact of the world economy on U.S. economic welfare. International issues are introduced early and are discussed often. For example, the rest of the world is introduced as an economic actor in Chapter 1 and comparative advantage and the production possibilities frontier are each discussed from a global perspective in Chapter 2. The international coverage is not simply an afterthought but is woven into the text to enhance the entire presentation. For example, students gain greater perspective about such topics as economic growth, unemployment, inflation, federal deficits and debt, central banks, tax rates, and the distribution of income if the U.S. experience is compared with that of other countries around the world. And recent trends in the competitive structure of the U.S. economy cannot be fully understood without examining the role of imports, trade barriers, and trade agreements. Likewise, students can better understand how free markets allocate resources when problems confronting the transitional economies around the world are examined. In addition to integrating coverage of international topics throughout, there are three chapters devoted

exclusively to the international issues. One of these three focuses on developing and transitional economies. International case studies include discussion of Mexico's peso problem, privatizing foreign aid, the World Trade Organization, and purchasing power parity and the price of a Big Mac.

ORGANIZATION

In many principles textbooks, chapters are interrupted by boxed material, parenthetical explanations, and other distractions that disrupt the flow of the chapter. Segregating material from the mainstream of a chapter leaves students uncertain about when or if this material should be read. In contrast, this book has a natural flow. Each chapter opens with a motivating paragraph and a list of key ideas, then tells a compelling story, using logical sections and subsections. Qualifying footnotes are used sparingly, and parenthetical explanations are used hardly at all. Moreover, case studies appear in the natural sequence of the chapter. Students can thus read each chapter smoothly from beginning to end. In this edition I have adopted a "just-in-time" philosophy; the idea is to introduce material as it is needed to develop an argument, not before. Overall, the Fourth Edition is a bit leaner, economic jargon has been reduced, and many tables have been converted to charts and graphs.

The Fourth Edition includes as an option material referencing the Internet, a valuable resource with more potential today than perhaps any other available on campus. Over 22 million distinct World Wide Web sites exist around the world, most with many levels, multiple materials, and colorful graphics. Computer users can "point and click" to navigate between pages within a site and among different sites. The Internet can be a powerful learning tool, a resource that has its place in the economics curriculum. Although Internet addresses and related material supplement each chapter, this is all optional. *Instructors who choose not to rely on the Internet-related material can still utilize in full all other features of the textbook.* The book is designed to be used either way.

Each chapter includes the following features.

Case Studies. Each chapter contains two case studies, or extended examples, that connect economic theory to the real world. Case studies are carefully inte-

grated into the presentation of the text, so the discussion flows uninterrupted. Exercises related to the case studies are included with the end-of-chapter questions and problems. Accompanying every case study is an interactive Internet example offering one or more World Wide Web site addresses for students to visit, explore, or browse materials related to the case study. These "links" are optional tools for discovering the latest information, or for visiting online the major actors of the case study. These links also appear within the McEachern Economics Web site (<http://www.thomson.com/mceachern/>).

Net Bookmarks. In addition to the interactive Internet examples, tied to the case studies, every chapter includes a Net Bookmark. Similar to the interactive Internet examples, Net Bookmarks offer students the option to explore World Wide Web resources tied to key concepts in the chapter. Rather than relying only on sites that offer data—as useful as these sites are to economists—I have chosen sites based on their economic relevance and interest to principles students. These links are also contained conveniently within the McEachern Economics Web site (<http://www.thomson.com/mceachern/>).

End-of-Chapter Material. Each chapter contains both a *Conclusion* and a *Summary*. The Conclusion draws the discussion to a close; the Summary reviews the key points. Each chapter ends with, on average, 20 questions and problems. Many questions are analytical, requiring the student to perform calculations or to draw graphs. Suggested answers to questions and problems are provided in the *Instructor's Manual*. New to this edition are *Using the Internet Problems*, which offer students the opportunity to use Internet resources to solve economic problems. These problems are contained within the McEachern economics Web site.

Appendixes. Several end-of-chapter appendixes provide more detailed treatment of various topics. The appendix to Chapter 1, for example, is recommended for all students unfamiliar with variables, graphs, slopes, and the like. Other appendixes are optional in the sense that subsequent material does not rely on them. Including additional material in this way offers the instructor greater flexibility of coverage with no loss of continuity.

Marginal Definitions and Glossary. Important economic terms appear in boldface type and are defined in the body of the text. These terms are also defined in the margins and listed alphabetically in the *Glossary*, which appears at the end of the book, just before the index.

CLARITY BY DESIGN

In many textbooks, the design of the pages—the layout of the page and the use of color—is usually an afterthought, without regard to how students read and understand a textbook. By contrast, this book has a natural flow and a systematic use of color. No element of the design is wasted, and all elements work efficiently together for the maximum pedagogical value.

Page Design. By design, each element of the chapter builds upon the next. From the opening, motivating paragraph to the conclusion and summary, each chapter has a consistent flow. Case studies, as do photographs and Net Bookmarks, appear in the natural sequence of the chapter. Although each chapter contains numerous examples and features, none is set off in a box. Students can thus read each chapter smoothly from beginning to end without a hitch. In addition, every effort has been made to present students with an open, readable page design. The size of the print, the length of the text line, and the amount of “white space” are all optimal for students encountering college textbooks for the first time. Nearly all graphs are accompanied by captions that explain the key features.

Use of Color. Color is used systematically within graphs, charts, and tables to ensure that students quickly and easily comprehend these exhibits. Throughout the book, demand curves are blue and supply curves are red. In comparative statics, the curves determining the final equilibrium point are darker than the initial curves. Color shading highlights the underlying data for easy recognition, such as measures of economic profit or loss, tax incidence, consumer and producer surplus, and the welfare effects of tariffs and quotas. In short, color is more than mere face entertainment—it is employed consistently and with forethought as a pedagogical aid.

THE SUPPORT PACKAGE

The teaching and learning support package accompanying *Macroeconomics: A Contemporary Introduction* provides instructors and students with focused, accurate, and innovative supplements to the textbook.

Student Supplements

Study Guide. The *Study Guide* is available for the hardbound text, as well as in Macro and Micro versions. Each *Study Guide* chapter includes the following: (1) an introduction; (2) a chapter outline, with definitions of all terms; (3) a discussion of the chapter’s main points; (4) a “lagniappe,” or bonus, which supplements the material in the chapter and includes a “Question to Think About”; (5) a list of key terms; (6) a variety of true or false, multiple choice, and discussion questions; and (7) answers to all of these questions. Visit the McEachern Economics Web site for more details (<http://www.thomson.com/mceachern>), or visit your local bookstore.

Virtual Economics: Principles and Applications. *Virtual Economics*, created by Willie Belton, Richard Cebula, and John McLeod, Jr., all of the Georgia Institute of Technology, is a self-contained CD-Rom economics adventure. Using a flexible, modular approach and an engaging, multimedia format, students experience the world of economics firsthand. *Virtual Economics* combines cutting-edge presentations with powerful graphing manipulation software and realistic simulations to provide students with the latest tools for learning economics—all with just a click of the mouse.

EconoGuide Student Software. Students have an opportunity to apply what they have learned and test their knowledge of economic concepts with *EconoGuide*, a Windows-based tutorial and assessment software program. The software is fully copyable and networkable.

McEachern Economics Web Site. As mentioned already, the Internet can be a powerful learning tool. To get the most from this promising tool, students and educators need what is provided with the Fourth Edition—well-defined applications in the text and in supplementary materials, as well as clear

directions for their use. The Fourth Edition offers a structured tour of economic resources on the Internet. Over 140 interactive examples and exercises in the text—Case Study Interactive Examples, Net Bookmarks, and Using the Internet Problems—provide a clear map to relevant and interesting sites. Many addresses will take students around the world. These applications are interesting but simple to use. And, to keep references to Internet sites current and accurate, technical support for these applications is provided by South-Western College Publishing within the McEachern Economics Web site (<http://www.thomson.com/mceachern>). Also at the McEachern Economics Web site, students can print a chapter from the *Study Guide*, download the software for free, join the Internet Student Discussion Group (as can instructors join the Internet Instructor Discussion Group), and take advantage of other benefits associated with using the Fourth Edition. *Importantly, nothing about these applications requires a detailed knowledge of the Internet.* All this material represents optional paths for further study and exploration. Nothing more is needed than curiosity and access to e-mail and the World Wide Web.

Graphing Primer. The *Graphing Primer* shows students how to construct and interpret graphs that appear in the text.

Instructor Supplements

Test Bank A. Thoroughly revised for relevancy and consistency, *Test Bank A* contains over 7,000 questions in multiple choice, true or false, and short-answer formats. New to this edition are over 150 short-answer questions.

Test Bank B. Coordinated by the author of *Test Bank A*, *Test Bank B* offers 2,000 original questions.

MicroExam A and MicroExam B. *MicroExam A* and *MicroExam B* offer the printed *Test Banks A* and *B* in electronic form for instant test generation. The easy-to-use software allows you to edit questions and print graphs.

Hypermedia Electronic Presentation Software for Windows. For each chapter of McEachern, *Hypermedia Electronic Presentation Software* provides instructors

with a self-contained lecture resource. The software allows instructors to shift curves and display lecture notes and materials from the text.

PowerPoint Slides. Key materials from the text, as well as additional instructional materials, are available on *PowerPoint* slides to help enhance lectures and integrate technology into the classroom,

Transparency Acetates. Over 150 tables and graphs from the book are reproduced as full-color transparency acetates. Many of the acetates are “hinged” so that instructors may build complex graphs step by step.

CNBC Video Library. Hard-hitting, real-world business and economic events come to life in the classroom through exclusive CNBC videos. Short and long video clips are included for each chapter to highlight issues discussed in the text.

Teaching Assistance Manual. The *Teaching Assistance Manual* provides additional support beyond the *Instructor's Manual* and may be especially useful to new instructors, graduate assistants, and teachers interested in generating more class discussion. This manual offers (1) overviews and outlines of each chapter; (2) chapter objectives and quiz material; (3) material for class discussion; (4) topics warranting special attention; (5) supplementary examples; and (6) “What if?” discussion questions. Four appendixes provide guidance on (a) presenting material; (b) generating and sustaining class discussions; (c) preparing, administering, and grading quizzes; and (d) coping with the special problems confronting foreign graduate assistants.

The Teaching Economist. Since 1990 I have edited *The Teaching Economist*, a newsletter aimed at making teaching more interesting and more fun. The newsletter discusses new and imaginative ways to present topics—for example, how to “sensationalize” economic concepts, useful resources on the Internet, economic applications from science fiction, and more generally, ways to teach just for the fun of it. A regular feature of *The Teaching Economist*, “The Grapevine,” offers teaching ideas suggested by colleagues from across the country. (Past issues of *The Teaching Economist* are reprinted at the end of the *Teaching Assistance Manual*.)

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William A. McEachern

About the Author

William A. McEachern is Professor of Economics at the University of Connecticut. Since 1973 he has taught principles of economics and in 1980 developed a series of annual workshops for teaching assistants. He has given teaching workshops around the country. He earned an undergraduate degree *cum laude* in the honors program from Holy Cross College and an M.A. and a Ph.D. from the University of Virginia. He has authored several books and monographs in public finance, public policy, and industrial organizations. His research has appeared in edited volumes as well as journals such as *Economic Inquiry*, *National Tax Journal*, *Southern Economic Journal*, *Journal of Industrial Economics*, *Kyklos*, *Quarterly Review of Economics and Business*, *Challenge*, and *Public Choice*. He is Editor-in-Chief of *The Connecticut Economy: A University of Connecticut Quarterly Review* and has advised federal, state, and local governments on policy matters and directed a bipartisan commission examining Connecticut's finances. Professor McEachern has been quoted in publications such as *The Wall Street Journal*, *New York Times*, *Christian Science Monitor*, and *USA Today*. He has received the University of Connecticut's Faculty Award for Distinguished Public Service.

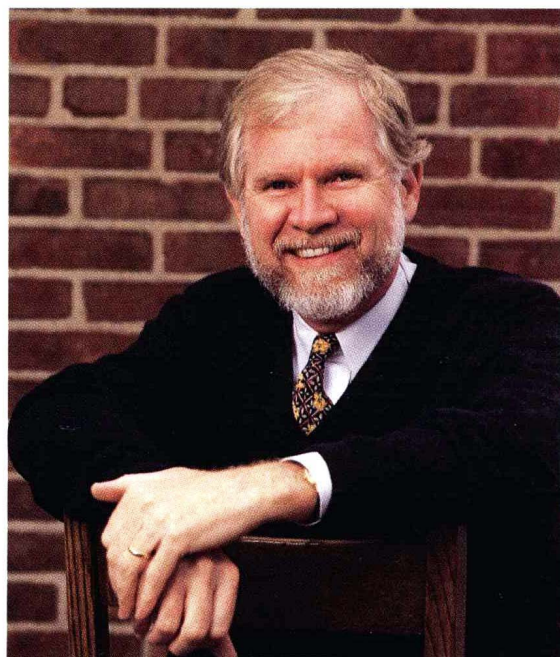


Photo by Peter Morenus/UConn

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