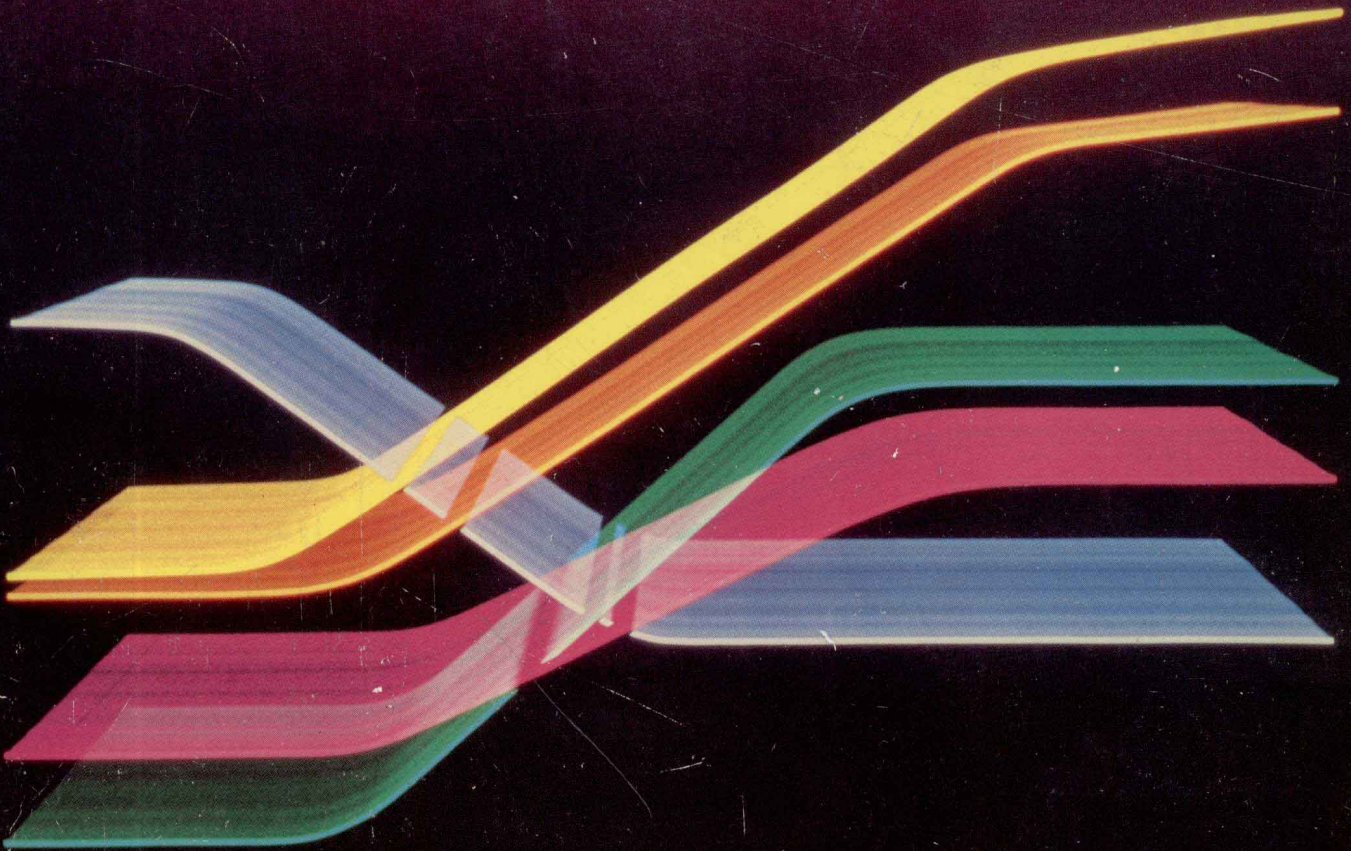


Principles of Macroeconomics

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Scott, Foresman and Company

Glenview, Illinois

Dallas, Texas Oakland, New Jersey
Palo Alto, California Tucker, Georgia London, England

To Roy Ruffin, Sr., Blanche Ruffin, and Annemarie Gregory

**Library of Congress Cataloging in Publication
Data**

Ruffin, Roy, 1938-

Principles of macroeconomics.

Includes index.

1. Economics. I. Gregory, Paul R. II. Title.

HB171.5.R82 1983 .330 82-16946

ISBN 0-673-15856-X

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Printed in the United States of America.

456-RRW-868584

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To the Instructor



This book provides the most modern treatment of macroeconomics that is currently available. Keynesian (demand-side) economics is covered thoroughly as a prelude to the presentation of modern aggregate demand/aggregate supply analysis. The role of expectations is stressed throughout the presentation of macroeconomic theory. Although a full chapter is devoted to rational expectations, this chapter can be considered optional because the student is given the fundamentals of rational expectations theory in the chapters on inflation and stabilization policy. Empirical data and abundant real-world examples reinforce the student's learning of macroeconomics.

Organization

This book is organized into three parts. Part I (Chapters 1–4) introduces the basic concepts of economics that must be learned before proceeding to the study of macroeconomics. These four chapters contain the standard topics of economic methodology, how to read graphs, scarcity, opportunity costs, the production-possibilities frontier, the law of diminishing returns, the law of comparative advantage, the workings of the price system, and the laws of supply and demand. In addition, the

student is introduced to the concepts of relative prices and marginal decision making, which are crucial topics in modern macroeconomics with its emphasis on supply-side phenomena.

The macroeconomics sequence begins in Part II with the basic macroeconomic concepts of inflation, unemployment, and the business cycle (Chapter 5), followed by national income accounting (Chapter 6). Monetary economics (in Chapters 7 and 8) is placed between national income accounting and the chapters on Keynesian economics (Chapters 9–11). Although the monetary chapters could be taught following Chapter 10 (on the multiplier), the present location allows the instructor to move directly into monetary policy and the modern model of aggregate demand and supply. We believe it is easier to recall national income accounting while touring money than to recall the Keynesian model while touring money. In addition, learning the deposit multiplier appears to make it easier for students to learn the somewhat more difficult concept of the expenditure multiplier.

The core of modern macroeconomics is found in Chapters 12–14. Chapter 12 introduces the basic tools and concepts of aggregate demand and supply and the natural-rate hypothesis. Chapters 13 and 14 give a thorough analysis of the causes of inflation and modern views on the Phillips curve. Chapters 15–17 round out the discussion of modern macroeconomics by focusing on the debates on stabilization policy (Chapter 15), the trends and causes of unemployment (Chapter 16), and rational-expectations theory (Chapter 17). Growth and development are discussed in Chapters 18 and 19. Part III is a three-chapter unit on international economics.

Suggestions for Course Planning

This book is intended for a one-semester course in macroeconomics that is traditionally taught as a first- or second-year college course. The text for the microeconomics course is also available in a softbound volume, and a hardbound volume is available that contains both microeconomics and macroeconomics chapters.

The instructor teaching a quarter course in macroeconomics can build a course around the 15 core chapters listed below, incorporating material from the remaining 7 chapters in this book as time and interest allow.

- 1 The Nature of Economics
- 2 The Economic Problem
- 3 The Price System
- 4 The Mechanics of Supply and Demand
- 5 Macroeconomic Concepts
- 6 Measuring National Income and National Product
- 7 Money and Prices
- 8 Commercial Banking and the Federal Reserve
- 9 Keynesian Economics
- 10 Output Fluctuations: The Multiplier and the Accelerator
- 11 Keynesian Monetary and Fiscal Policy
- 12 Aggregate Demand and Aggregate Supply
- 13 Inflation
- 14 Inflation and Unemployment
- 15 Stabilization Policy

Instructors who want a course with a focus on growth and development should incorporate Chapters 18 and 19 on Economic Growth and Problems of Population and Economic Development. Instructors who want a course with a focus on international economics should incorporate Chapters 20–22 on International Trade and Comparative Advantage, Protection and Free Trade, and the International Monetary System.

Supplements

This book has a complete package of supplements, which includes an *Instructor's Manual*, *Study Guide*, *Test Bank*, and *Transparency Masters*.

The *Instructor's Manual* was written by the authors. Each of the 41 chapters contains sections on: points to learn in the chapter, chapter organization, special approaches, optional material, teaching hints and special projects, bad habits to unlearn, additional essay questions, answers to end-of-chapter "Questions and Problems," and answers to the "Review Quiz" for that chapter in the *Study Guide*.

The *Instructor's Manual* is a valuable teaching aid because it supplies the instructor with additional numerical examples not contained in the text and additional real-world illustrations not discussed in the text. A chapter outline gives a brief overview of the material in the chapter that assists the instructor in preparing lecture outlines and in seeing the logical development of the chapter. The special-approaches section tells the instructor how this chapter is different from other textbooks and explains why a topic was treated differently in this text or why an entirely new topic not covered by other texts was introduced in the chapter. The optional-material section gives the instructor a ranking of priorities for the topics in the chapter and enables the instructor to trim the size of each chapter (if necessary).

The *Study Guide* was written by John Vahaly of the University of Louisville. Because the *Study Guide* is quite analytical, it will challenge the student and help him or her to better prepare for exams. The *Study Guide* supplements the text by providing summaries of the crucial elements. It contains multiple-choice and true/false questions, but unlike other study guides, it contains not only the answers to the multiple-choice and true/false questions but also *explanations for the answers*. Instead of just giving lists of the correct *a*, *b*, *c* responses or a list of *Ts* and *Fs*, the *Study Guide's* answer sections explain *why* a particular objective answer is the correct one. In addition to objective questions, each chapter of the *Study Guide* also contains analytical problems and questions. Again, the *Study Guide* provides not only the answers to the questions, but the step-by-step process for arriving at the answer.

At the back of the *Study Guide* is a "Review Quiz" for each chapter that contains multiple-choice questions the answers for which do *not* appear in the *Study Guide* but do appear in the *Instructor's Manual*. These quizzes can be used by the instructor as homework or as chapter quizzes.

The authors have also prepared a *Test Bank* that contains nearly 1,800 multiple-choice questions—most of which have already been class tested. The answers have been checked and double checked to minimize the chances that any of the questions have more than one answer. For each chapter in the text, the *Test Bank* contains 4 different tests (coded A, B, C, or D). Whether the instructor is trying to compose a one-chapter quiz or a 23-chapter final exam, that instructor can choose from among the questions in the *Test Bank*, the questions in the "Review Quizzes" at the back of the *Study Guide*, or the additional essay questions in the *Instructor's Manual*—more than 2,300 questions in all. The *Test Bank* is available both on perforated paper in book form and on computer tape.

Transparency Masters suitable for overhead projectors are available for all key figures and tables (about 150 items).

To the Student



How to Understand Economics

Many students find economics a difficult subject because, unlike many other courses a college student takes, economics cannot be mastered through memorization. Economics relies on economic theories to explain real-world occurrences—like why people tend to buy less when prices rise or why increased government spending may reduce unemployment. An economic theory is simply a logical explanation of why the facts fit together in a particular way. If the theory were not logical, or if the theory failed to be confirmed by real-world facts, it would be readily discarded by economists.

The successful student will be the one who learns that economics is built upon a number of fairly simple and easy-to-understand propositions. These propositions and assumptions—that businesses seek to maximize profits or that consumers base their expenditure decisions on disposable income, for example—form the building blocks upon which economics is based. These propositions are typically little more than common sense and should not intimidate a student. If a major building block is missing, however, the whole structure can fall apart. To prevent the student from overlooking or forgetting a crucial building block, we frequently engage in pedagogical review. In other words, when a new proposition is added to a theoretical structure, the underlying propositions are reviewed.

Another factor that can make economics difficult for a student is that economics—like other academic disciplines—has its own specific vocabulary. Unlike the physical sciences, however, where the student may be encountering a certain term for the first time, much of the vocabulary of economics—terms like *efficiency*, *capital*, *stock*, *unemployment*—has a common usage that is already familiar to the student. Economists, however, use the vocabulary of economics in a very exact way, and often the common usage of a term is not the same as the economic usage. In this book, each key term appears in boldface type where it is first discussed in text. Immediately following the paragraph where the term first appears in boldface type, the formal, economic definition of the term is set off in color. At the end of each chapter is a list of all the key terms that have been boldfaced and given formal definitions in that chapter; a glossary at the end of the book contains all the definitions of key terms and gives the chapter number in which the term was defined.

The modern developments in economics are simply new attempts to explain in a logical manner how the facts bind together. Modern developments have occurred because of the realization that established theories were not doing a good job of explaining the world around us. Fortunately, the major building blocks of modern theory—that people attempt to anticipate the future, that rising prices motivate wealth holders to spend less, that people and businesses gather information and make decisions in a rational manner—rely on common-sense logic.

Economics is only valuable if it explains the real world. Economics should be able to answer very specific questions like: Why are there three major domestic producers of automobiles and hundreds or even thousands of producers of textiles? Why is there a positive association between the growth of the money supply and inflation? Why does the United States export computers and farm products to the rest of the world? Why do restaurants rope off space during less busy hours? If Iowa corn land is the best land for growing corn, why is corn also grown in Texas while some land stands idle in Iowa? Why do interest rates rise when people expect the inflation rate to increase? Why did the price of petroleum rise so rapidly in the 1970s? The successful student will be able to apply the knowledge he or she gains of real-world economic behavior to explain any number of events that have already occurred or are yet to occur.

In writing this book, we have made a conscious effort to present arguments and evidence on both sides of every economic controversy. We attempt to make a case for each distinct viewpoint, even if it would be more interesting and less complicated to come out strongly in one camp. Although we are aware of our own free-market bias, we believe it is best to allow the student to keep an open mind at this very early stage in the study of economics.

Learning Aids

This book contains a number of important learning aids.

1. The *Chapter Preview* that precedes each chapter provides a brief overview of the important points to be learned in that chapter.
2. *Definitions of Key Terms* are set off in color following the paragraphs in which the terms are introduced in context.
3. *Key Ideas*, important economic principles or conclusions, are set off in color in bold, italicized type.
4. *Boxed Examples* allow the student to appreciate how economic concepts apply in real-world settings without disrupting the flow of the text and supplement the numerous examples already found in the text discussions.
5. A *Chapter Summary* of the main points of each chapter is found at the end of each chapter.

6. *Key Terms* that were defined in color in the chapter are listed at the end of each chapter.
7. *Questions and Problems* that test the reader's understanding of the chapter follow each chapter.
8. A *Glossary*, containing all key terms defined in color in chapters and listed in chapter "Key Terms" sections, appears at the end of the book. Each entry contains the complete economic definition as well as the number of the chapter where the term was first defined.
9. The *Index* of all the names, concepts, terms, and topics covered in the book is one of the most thorough indexes ever compiled for an introductory economics text.
10. Statistical data on the major economic variables are found on the front and back inside covers for easy reference.
11. *Suggested Readings* are listed for each chapter at the back of the book.

Acknowledgments



We are deeply indebted to our colleagues at the University of Houston who had to bear with us in the writing of this book. Gary Smith, Richard Bean, Joel Sailors, Thomas DeGregori, James Griffin, Dean George Daly, Peter Mieszkowski, Peter Zadrozny, Art DeVany, Louis Stern, Oded Palmon, and Thomas Mayor gave their time freely on an incredible number of pedagogical points in the teaching of elementary economics.

We are also grateful for the suggestions and contributions of numerous colleagues across the country who reviewed this manuscript in various stages of its development:

David Abel	Mankato State University
Ken Alexander	Michigan Technical University
Susan Alexander	College of St. Thomas
Richard G. Anderson	Ohio State University
Richard K. Anderson	Texas A & M
Ian Bain	University of Minnesota
George Bittlingmayer	University of Michigan
Robert Borengasser	St. Mary's College
Ronald Brandolini	Valencia Community College

Wallace Broome	Rhode Island Junior College
Anthony Campolo	Columbus Technical Institute
Shirley Cassing	University of Pittsburgh
Robert E. Christiansen	Colby College
Richard Clarke	University of Wisconsin, Madison
David Denslow	University of Florida
Tim Deyak	Louisiana State University, Baton Rouge
Dan Friedman	University of California, Los Angeles (UCLA)
Janet Furman	Tulane University
Charles Gallagher	Virginia Commonwealth University
Ronald Gunderson	Northern Arizona University
Edward Howe	Siena College
James Johannes	Michigan State University
James Kahn	State University of New York, Binghamton
Chris Klisz	Wayne State University
Byung Lee	Howard University
Robert Lucas	University of Chicago
Ron Luchessi	American River College
Roger Mack	DeAnza College
Allan Mandelstamm	Virginia Polytechnic Institute
Jim McKinsey	Northeastern University
W. Douglas Morgan	University of California, Santa Barbara
Norman Obst	Michigan State University
John Pisciotta	Baylor University
John Pomery	Purdue University
Jennifer Roback	Yale University
Mark Rush	University of Florida
Robert Schmitz	Indiana University
David Spencer	Washington State University
Alan Stockman	University of Rochester
Don Tailby	University of New Mexico
Helen Tauchen	University of North Carolina
Robert Thomas	Iowa State University
Roger Trenary	Kansas State University
George Uhimchuk	Clemson University
Roberton Williams	Williams College
Gary Young	Delta State University (Mississippi)

It was a pleasure to work closely with John Vahaly who, in addition to preparing the *Study Guide*, provided valuable and insightful comments on every chapter of this book.

We wish to thank George Lobell, economics editor at Scott, Foresman, who gave us encouragement and advice throughout the writing of this book. The skillful editing of the work was in the able hands of Mary LaMont, developmental editor at Scott, Foresman, whose contributions to style and content grace every page.

Special thanks go to Janet Blackburn, Annemarie Gregory, Roselyn Kennelly, Jane Wang, and Khalil Yazdi.

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