

Contents

List of Figures *xi*
List of Tables *xvi*
List of Boxes *xviii*

PART I

Introduction to Macroeconomics 1

1 What is Macroeconomics? 3

- 1.1 Overview 4
- 1.2 Macroeconomics as a Discipline 10
- 1.3 The Methodology of Macroeconomics 14
- 1.4 Preview of the Book 17

2 Macroeconomic Accounts 21

- 2.1 Overview 22
- 2.2 Gross Domestic Product 22
- 2.3 Flows of Incomes and Expenditures 30
- 2.4 Balance of Payments 36
- Summary 40

PART II

The Real Macroeconomy 43

3 Economic Growth 45

- 3.1 Overview 45
- 3.2 Stylized Facts and Steady States 47

3.3 Capital Accumulation 49

3.4 Population Growth 58

3.5 Technological Progress 61

3.6 Putting It All Together: Growth Accounting 62

3.7 Endogenous Growth: A Primer 65

Summary 67

4 Labour Markets and Unemployment 71

- 4.1 Overview 72
- 4.2 Demand and Supply in the Labour Market 73
- 4.3 A Static Interpretation of Unemployment 82
- 4.4 A Dynamic Interpretation of Unemployment 90
- 4.5 The Equilibrium Rate of Unemployment 94
- Summary 97

5 Borrowing, Lending, and Budget Constraints 101

- 5.1 Overview 102
- 5.2 Thinking about the Future 103
- 5.3 The Household's Intertemporal Budget Constraint 104
- 5.4 The Firm and the Private Sector's Intertemporal Budget Constraint 108

5.5 Public and Private Budget Constraints 113**5.6 The Current Account and the Budget Constraint of the Nation 120**

Summary 122

6 Private Sector Demand: Consumption and Investment 125**6.1 Overview 126****6.2 Consumption 127****6.3 Investment 138**

Summary 148

7 The Real Exchange Rate 151**7.1 Overview 152****7.2 The Real Exchange Rate and the Primary Current Account Function 153****7.3 The Real Exchange Rate as the Relative Price of Non-traded Goods 156****7.4 The National Intertemporal Budget Constraint and the Equilibrium Real Exchange Rate 161**

Summary 168

PART III**Money 171****8 Money and the Demand for Money 173****8.1 Overview 174****8.2 Technical Definitions of Money 174****8.3 Why Is this Money? 177****8.4 Money: A Balance Sheet Approach 179****8.5 The Demand for Money 181****8.6 Equilibrium in the Money Market: The Short Run 186****8.7 Equilibrium in the Money Market: The Long Run 188**

Summary 194

9 The Supply of Money and Monetary Policy 199**9.1 Overview 200****9.2 Objectives, Targets, and Instruments 201****9.3 Money Creation 203****9.4 Controlling Monetary Conditions 209****9.5 Monetary Policy in an Open Economy 216****9.6 Monetary Financing of the Government: A Slippery Objective 217****9.7 Bank Regulation and Monetary Control 220**

Summary 223

PART IV**Macroeconomic Equilibrium 227****10 Aggregate Demand, Output, and the Interest Rate 229****10.1 Overview 230****10.2 Aggregate Demand and the Goods Market 232****10.3 The Goods Market and the IS Curve 237****10.4 The Money Market and the LM Curve 241****10.5 International Capital Flows and Macroeconomic Equilibrium 243****10.6 Output and Interest Rate Determination under Fixed Exchange Rates 246****10.7 Output and Interest Rate Determination under Flexible Exchange Rates 252****10.8 Fixed and Flexible Rates: A Wrap-Up 255**

Summary 256

11 Output, Employment and Prices 261**11.1 Overview 262****11.2 The IS-LM Model 263****11.3 General Equilibrium 264**

- 11.4 General Equilibrium with Flexible Prices:
The Neoclassical Case 268
- 11.5 General Equilibrium with Sticky Prices:
The Keynesian Case 272
- Summary 276

PART V

Inflation and Business Cycles 279

- 12 Aggregate Supply and Inflation 281
 - 12.1 Overview 282
 - 12.2 The Phillips Curve: Chimera or a Stylized Fact? 283
 - 12.3 Accounting for Inflation: The Battle of the Mark-ups 288
 - 12.4 Inflation, Unemployment, and Output 294
 - Summary 299
- 13 Aggregate Demand and Aggregate Supply 303
 - 13.1 Overview 304
 - 13.2 Aggregate Demand and Supply under Fixed Exchange Rates 305
 - 13.3 Aggregate Demand and Supply under Flexible Exchange Rates 315
 - 13.4 How to Use the AS-AD Framework 319
 - Summary 327
- 14 Business Cycles 331
 - 14.1 Overview 332
 - 14.2 Stylized Facts about Business Cycles 333
 - 14.3 Deterministic and Stochastic Interpretations of the Business Cycle 341
 - 14.4 Sticky Price Business Cycles 346
 - 14.5 Real Business Cycles 349
 - 14.6 Taking Stock of the Two Theories 352
 - Summary 355

PART VI

Macroeconomic Policy 359

- 15 Fiscal Policy, Debt, and Seigniorage 361
 - 15.1 Overview 362
 - 15.2 Fiscal Policy and Economic Welfare 363
 - 15.3 Macroeconomic Stabilization 365
 - 15.4 Deficit Financing: Public Debt and Seigniorage 373
 - 15.5 Three Ways to Stabilize the Public Debt 376
 - Summary 379
- 16 The Limits of Demand Management 383
 - 16.1 Overview 384
 - 16.2 Policy Activism and Demand Management: What are the Issues? 385
 - 16.3 Macroeconomic Policy and Expectations 393
 - 16.4 The Institutions of Policy-Making 394
 - 16.5 Politics and Economics 402
 - Summary 404
- 17 Supply-Side Policy 407
 - 17.1 Overview 408
 - 17.2 Market Efficiency and Equilibrium Output 409
 - 17.3 Improving the Effectiveness of Goods Markets 414
 - 17.4 Improving the Efficiency of Labour Markets 420
 - Summary 432
- 18 Economic Growth: Theory and Policy 435
 - 18.1 Overview 436
 - 18.2 Growth and Complementary Inputs 437

- 18.3** Growth, Knowledge, and Innovation 441
- 18.4** Growth and the Economic Environment 446
- 18.5** Growth and Politics 452
- Summary 454

PART VII

Asset Markets and International Financial Architecture 457

19 Asset Markets and Macroeconomics 459

- 19.1** Overview 460
- 19.2** How Asset Markets Work 460
- 19.3** Linking Asset Markets and Macroeconomics 470
- 19.4** Exchange Rate Determination in the Short Run 479
- Summary 486

20 The Architecture of the International Monetary System 491

- 20.1** Overview 492
- 20.2** History of Monetary Arrangements 493
- 20.3** The International Monetary Fund 504
- 20.4** Currency Crises 506
- 20.5** The Choice of an Exchange Rate Regime 514
- Summary 521

21 Epilogue 525

- 21.1** The Keynesian Revolution 526
- 21.2** The Monetarist Revolution 528
- 21.3** The Rational Expectations Revolution 531
- 21.4** Microfoundations of Macroeconomics 532
- 21.5** Institutional and Political Economics 533
- 21.6** Labour Markets 534
- 21.7** Growth and Development 536
- 21.8** Conclusions 537

References 539

Glossary 541