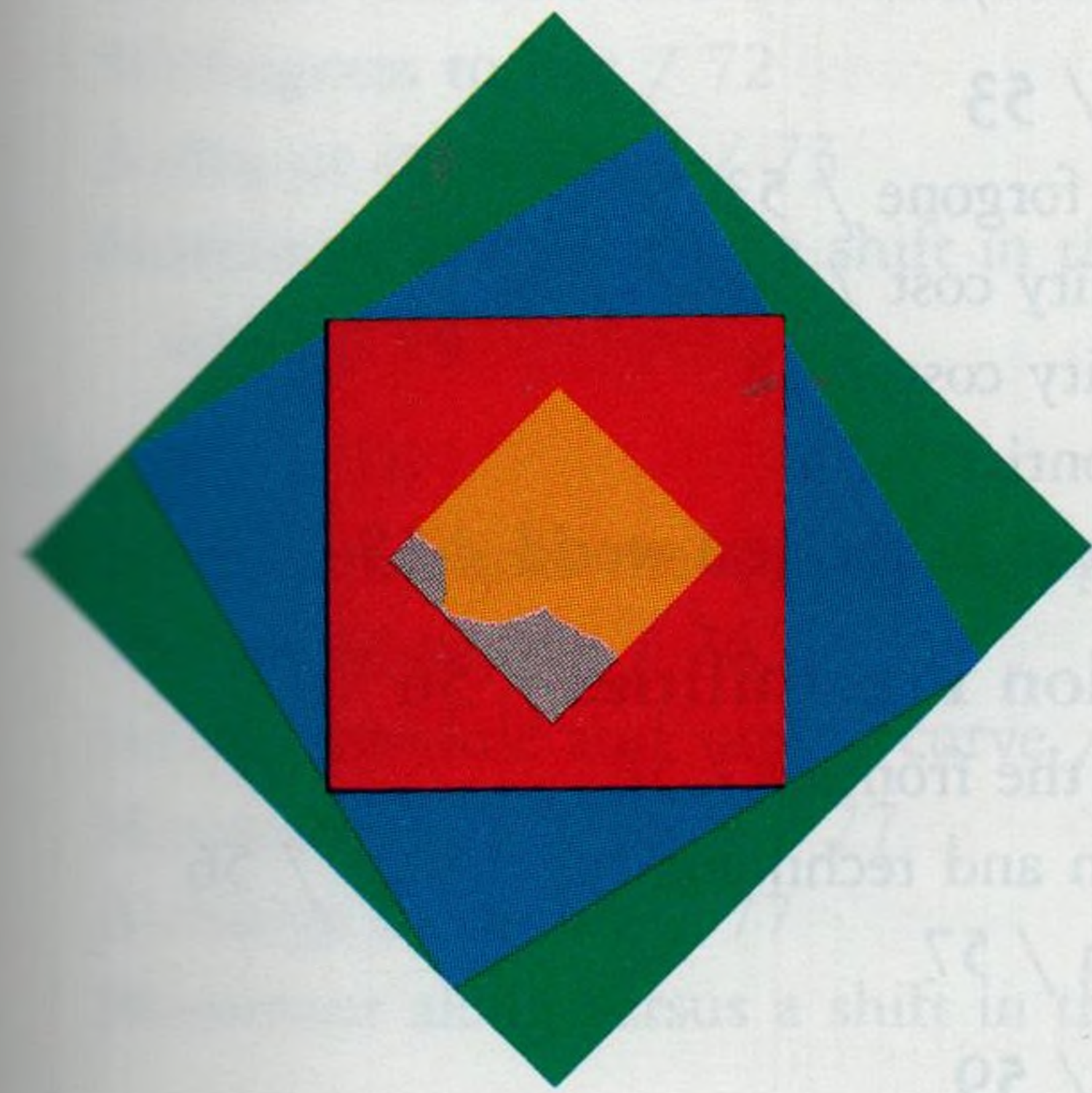


Contents



Chapter 1 What Is Economics? 5

Seven Big Questions / 6

- Production, consumption, and technological change / 6
- Wages and earnings / 7
- Unemployment / 7
- Inflation / 7
- Government / 7
- International trade / 8
- Wealth and poverty / 8
- Big questions with no easy answers / 8

Scarcity / 9

- Economic activity / 9
- Choice / 10
- Opportunity cost / 10
- Competition and cooperation / 10

The Economy / 11

- What is an economy? / 12
- The economy's working parts / 12
- Coordination mechanisms / 14
- Closed and open economies / 16

Economic Science / 17

- What is and what ought to be / 17
- Observation and measurement / 18
- Economic theory / 18
- Economic model / 18
- Microeconomic and macroeconomic models / 20
- Model, theory, and reality / 21

Our Advancing Knowledge

Adam Smith and the Birth of Economic Science / 22

Summary † / 24

Key Concepts / 25

Review Questions / 26

Problems / 26

†Summary, Key Concepts, Review Questions, and Problems appear at the end of each chapter.

Chapter 2 Making and Using Graphs 27*Three Kinds of Lies / 28***Graphing Data / 29**

Two-variable graphs / 29

Time-series graphs / 30

Scatter diagrams / 35

Graphs Used in Economic Models / 38

Things that go up and down together / 38

Things that move in opposite directions / 39

Things that have a maximum and a minimum / 39

Things that are independent / 40

The Slope of a Relationship / 41

The definition of slope / 41

Calculating slope / 41

Graphing Relationships Among More Than Two Variables / 44

Other things being equal / 44

Chapter 3 Production, Specialization, and Exchange 49*Making the Most of It / 50***The Production Possibility Frontier / 51**

A model economy / 51

On the frontier is best? / 52

Opportunity Cost / 53

The best alternative forgone / 53

Measuring opportunity cost / 54

Increasing opportunity cost / 54

The shape of the frontier / 55

Production possibilities in the real world / 55

Changing Production Possibilities / 56

The cost of shifting the frontier / 56

Capital accumulation and technological change / 56

The real world again / 57

Gains from Trade / 59

Comparative advantage: Jane meets Joe / 59

Reaping the gains from trade / 60

Absolute advantage / 61

Exchange in the Real World / 62

Property rights / 62

Money / 63

Reading Between the Lines*Overcoming Obstacles to the Gains from Trade / 64*

Chapter 4 Demand and Supply 69

Slide, Rocket, and Roller Coaster / 70

Demand / 71

What determines the quantity demanded? / 71

The law of demand / 71

Demand schedule and demand curve / 72

Willingness to pay / 72

A change in demand / 73

Movement along versus a shift in the demand curve / 74

Supply / 76

What determines the quantity supplied? / 76

The law of supply / 76

Supply schedule and supply curve / 76

Minimum supply price / 77

A change in supply / 77

Movement along versus a shift in the supply curve / 78

Price Determination / 80

Price as a regulator / 80

Equilibrium / 80

Predicting Changes in Price and Quantity

Traded / 82

A change in demand / 83

A change in supply / 86

Changes in both supply and demand / 87

Walkmans, apartments, and coffee / 87

Our Advancing Knowledge

Discovering the Laws of Demand and Supply / 84

Reading Between the Lines

Demand and Supply in Action:

A Temporary Increase in Demand / 90

Reading Between the Lines

Demand and Supply in Action:

An Increase in Supply / 92

Chapter 22 Inflation, Unemployment, Cycles, and Deficits 101

Shopping Cart Blues / 102

Inflation / 103

The inflation rate and the price level / 103

The recent inflation record / 104

Inflation and the value of money / 104

Is inflation a problem? / 105

The problem of unanticipated inflation / 105

The problem of anticipated inflation / 107

Indexing / 108

Unemployment / 108

What is unemployment? / 108

Measuring unemployment / 108

The unemployment record / 109

The benefits and costs of unemployment / 109

Gross National Product / 111

Nominal GNP and real GNP / 112

Real GNP—The record / 112

The importance of real GNP / 113

The Business Cycle / 115

Unemployment and the business cycle / 116

The stock market and the business cycle / 116

Inflation and the business cycle / 118

Government Deficit and International Deficit / 119

Government deficit / 119

International deficit / 120

Chapter 23 *Measuring Output and the Price Level* 124

Reading the Tea Leaves / 125

The Circular Flow of Expenditure and Income / 126

Circular flows in a model economy / 126

Income and expenditure accounts / 130

U.S. National Income and Product Accounts / 131

The expenditure approach / 131

The factor incomes approach / 132

The output approach / 134

Measured and actual gross national product / 136

The Price Level and Inflation / 137

Consumer price index / 137

GNP deflator / 139

Inflation and relative price changes / 141

The consumer price index and the cost of living / 142

Reading Between the Lines

Consumer Prices in July

Increased by a Modest 0.2% / 144

Chapter 24 *Aggregate Demand and Aggregate Supply* 148

What Makes Our Garden Grow? / 149

Aggregate Demand / 150

Why the aggregate demand curve slopes downward / 151

Money and the real balance effect / 151

Changes in aggregate demand / 153

Shifts of the aggregate demand curve / 156

Aggregate Supply / 156

Long-run aggregate supply / 157

Short-run aggregate supply / 158

Changes in both long-run and short-run aggregate supply / 160

Changes in short-run aggregate supply / 161

Shifts in the aggregate supply curves / 161

Macroeconomic Equilibrium / 162

Determination of real GNP and the price level / 162

Macroeconomic equilibrium and full employment / 163

The effects of a change in aggregate demand / 164

The effects of a change in short-run aggregate supply / 166

Trends and Cycles in the U.S. Economy / 167

The economy in 1988–89 / 167

Growth, inflation, and cycles / 170

Reading Between the Lines

The Tightrope Between

Inflation and Recession / 168

Chapter 25 *Expenditure Decisions* 179

Fear and Trembling in the Shopping Aisles / 180

The Components of Aggregate Expenditure / 181

Relative importance of the components of aggregate expenditure / 181

Volatility of the components of aggregate expenditure / 181

Consumption Expenditure and Saving / 182

The consumption function and the saving function / 184

The average propensities to consume and to save / 185

The marginal propensities to consume and to save / 186

The U.S. consumption function / 188

Shifts in the consumption function / 189

The aggregate consumption function / 189

Investment / 191

What determines investment? / 191

Investment demand / 197

Accelerator principle / 197

Investment demand in the United States / 199

Net Exports / 201

Exports / 201

Imports / 202

Net export function / 203

Our Advancing Knowledge

Consumption and Saving / 192

Appendix: *Net Present Value and Investment* 207

Calculating Net Present Value / 207

Expected Inflation and Real Interest Rate / 208

Investment Demand / 209

Chapter 26 *Expenditure and Income* 210

Economic Amplifier or Shock Absorber? / 211

Aggregate Expenditure and Real GNP / 212

Aggregate expenditure schedule / 212

Aggregate expenditure curve / 213

Autonomous and induced expenditure / 214

Slope of the aggregate expenditure curve / 214

Equilibrium Expenditure / 215

When planned expenditure equals real GNP / 215

Convergence to equilibrium / 215

Fluctuations in Expenditure and in Real GNP / 217

A change in autonomous expenditure / 218

A change in the marginal propensity to spend / 218

The effects of a change in the marginal propensity to spend / 220

The paradox of thrift / 221

The Multiplier / 222

The multiplier and the marginal propensity to spend / 222

Why is the multiplier greater than 1? / 224

Fiscal policy multipliers / 226

The multiplier in recession and recovery / 228

Aggregate Expenditure and Aggregate Demand / 229

Aggregate planned expenditure and the price level / 229

Aggregate demand curve and autonomous expenditure / 231

Equilibrium GNP and the price level / 232

Chapter 27 Money, Banking, and Prices 237

Money Makes the World Go Around / 238

What Is Money? / 239

- The definition of money / 239
- The functions of money / 239
- The different forms of money / 241
- Money in the United States today / 243

Financial Intermediaries / 247

- Commercial banks / 250
- Other financial intermediaries / 251
- The economic functions of financial intermediaries / 252
- Financial innovation / 252
- How banks create money / 253
- Real world money multipliers / 255
- Bank panic and failure / 256

Money and the Price Level / 256

- Money in the AD-AS model / 256
- The quantity theory of money / 257
- Historical evidence on the quantity theory of money / 258
- International evidence on the quantity theory of money / 259

Reading Between the Lines

Economical Money / 248

Chapter 28 The Federal Reserve, Money, and Interest Rates 263

Fiddling with the Knobs / 264

The Federal Reserve System / 265

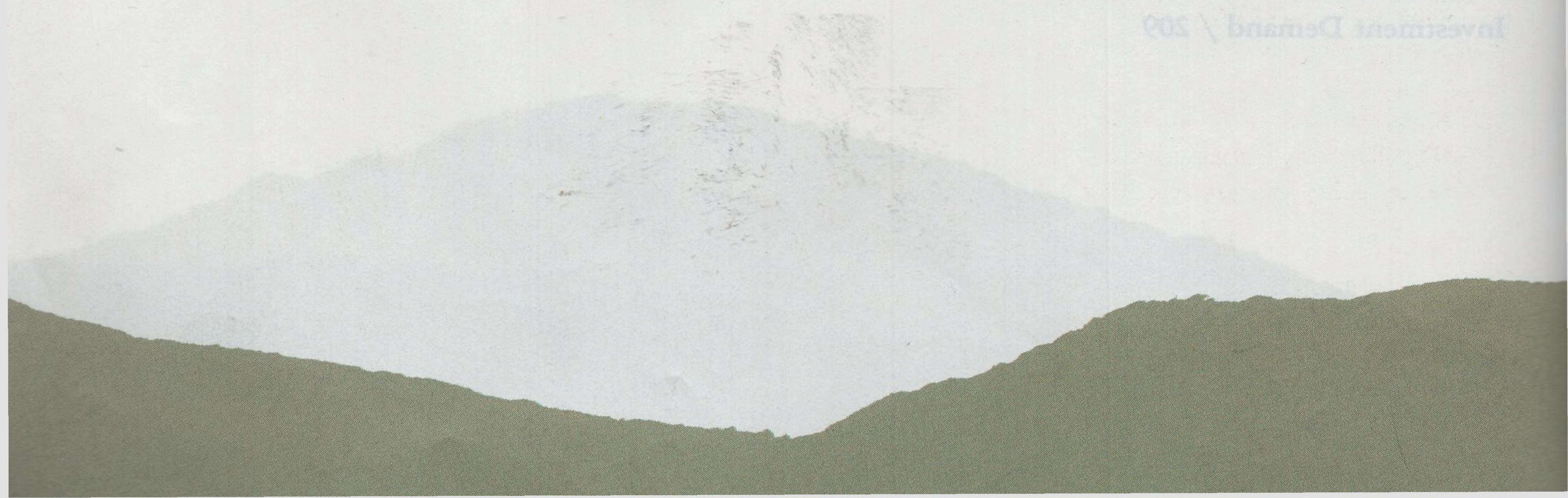
- The origins of the Federal Reserve System / 265
- The structure of the Federal Reserve System / 266
- The Fed's power center / 267
- Policy tools / 267
- The Fed's balance sheet / 269
- How open market operations work / 270
- The multiplier effect of an open market operation / 270
- The U.S. money multiplier / 273
- Other policy tools / 275

The Demand for Money / 276

- The motives for money holding / 277
- The influences on money holding / 277
- The demand for real money / 279
- Shifts in the demand curve for real money / 280
- The demand for money in the United States / 282

Interest Rate Determination / 284

- Interest rates and asset prices / 284
- Money market equilibrium / 284
- Changing the interest rate / 286
- The Fed in action / 286
- Profiting by predicting the Fed / 288



Chapter 29 Aggregate Demand and Fluctuations 291

Congress, the Fed, and the White House / 292

Money, Interest, and Aggregate Demand / 293

The interest rate transmission mechanism / 293

Adjustment process / 296

How potent is monetary policy? / 299

Time lags of monetary policy / 301

Policy formation lag / 302

Other transmission mechanisms / 302

Fiscal Policy and Aggregate Demand / 304

Fiscal and monetary policy interaction: Crowding out / 304

Influencing the composition of aggregate demand / 305

Politics of monetary and fiscal policy / 305

Fiscal policy and the exchange rate / 306

Time lags of fiscal policy / 306

The Keynesian–Monetarist Controversy / 307

Extreme Keynesianism / 307

Extreme monetarism / 311

The intermediate position / 311

Sorting out the competing claims / 311

Reading Between the Lines

Money and the Stock Market / 308

Appendix: The IS-LM Model of Aggregate Demand / 315

Equilibrium Expenditure and Real GNP / 315

The IS Curve / 317

Money Market Equilibrium / 317

The LM curve / 318

The equilibrium interest rate and real GNP / 319

The Aggregate Demand Curve / 320

The effects of a change in price level on the LM curve / 321

The aggregate demand curve derived / 322

Fiscal policy and aggregate demand / 322

Monetary policy and aggregate demand / 323

Chapter 30 Unemployment and Aggregate Supply 325

Jobs and Incomes / 326

The Short-run Aggregate Production Function / 327

The marginal product of labor / 327

Economic growth and technological change / 328

Variable growth rates / 329

The U.S. short-run aggregate production function / 329

The Demand for Labor / 330

Diminishing marginal product and the demand for labor / 331

The U.S. demand for labor / 332

The Supply of Labor / 333

The determination of hours per worker / 333

The participation rate / 335

Intertemporal substitution / 335

Wages and Employment / 335

The flexible wage theory / 336

The sticky wage theory / 339

Unemployment / 342

Indivisible labor / 342

Job search and unemployment / 342

Our Advancing Knowledge

Unemployment: Waste or “Natural”? / 344

Chapter 31 Expectations and Inflation 352***Wanted: A Crystal Ball / 353*****Macroeconomic Equilibrium / 354**

Equilibrium in the markets for goods, money, and labor / 354

Individuals in a macroeconomic equilibrium / 354

The effects of price level expectations / 355

The cost of wrong forecasts / 357

Minimizing the losses from wrong expectations / 357

The Rational Expectation of the Price Level / 358

How people form expectations in the “real world” / 358

How economists predict people’s forecasts / 358

Calculating a rational expectation of the price level / 358

Theory and reality / 362

Rational Expectations Equilibrium / 362

Individuals in a rational expectations equilibrium / 364

Inflation / 364

Anticipated inflation / 364

Unanticipated inflation / 365

The quantity theory of money / 367

U.S. inflation and money growth since 1960 / 371

Interest Rates and Inflation / 372

Expectations of inflation and interest rates / 373

Inflation and interest rates in the United States / 374

Money supply and interest rates again / 374

Our Advancing Knowledge

Expectations / 360

Our Advancing Knowledge

The Phillips Curve / 368

Chapter 32 Recessions and Depressions 378***What Goes Up Must Come Down / 379*****Two Recent Recessions / 380**

The origins of recent recessions / 380

Recession mechanism / 382

The labor market in recession / 385

Comparing the two recessions / 389

Another Great Depression? / 389

What the Great Depression was like / 389

Why the Great Depression happened / 393

Can it happen again? / 394

Reading Between the Lines***Monetary Policy in Action / 390***

Chapter 33 Stabilizing the Economy 403*Who's in Charge?* / 404**The Stabilization Problem** / 405

Macroeconomic policy targets / 405

Macroeconomic performance indexes / 406

The Key Players / 408

The Federal Reserve Board / 408

The Congress / 408

The administration / 409

Alternative Means Used to Stabilize the Economy / 410

Fixed rules and feedback rules / 410

Expectations and policy rules / 410

The two rules compared / 411

So feedback rules are better? / 412

Variability of aggregate demand with feedback rules / 416

Stabilization Policy and Aggregate Supply / 417

Cost-push inflation / 417

Slowdown in capacity growth / 418

Controlling inflation by announcing monetary policy / 420

Stabilizing the U.S. Economy in the 1980s and 1990s / 420

The Fed's finest hour? / 420

The Fed on a tightrope / 421

Our Advancing Knowledge*The Quantity Theory and Monetarism* / 424**Reading Between the Lines***Going for a Soft Landing* / 422**Chapter 34 The Deficit 426***Spendthrift Uncle Sam* / 427**The Sources of the Deficit** / 428

The federal budget since 1960 / 429

Taxes / 430

Expenditure / 431

The deficit and the business cycle / 431

The deficit in recovery / 432

The Real Deficit / 433

The real deficit of a family / 433

The government's real deficit / 434

The real and nominal deficit in the United States / 435

Deficits and Inflation / 436

Financing the deficit / 436

Unpleasant arithmetic / 437

A Burden on Future Generations? / 438

Crowding out / 438

Ricardian equivalence / 439

Eliminating the Deficit / 442

Reducing expenditure / 443

Increasing revenue / 445

Our Advancing Knowledge*David Ricardo and the Deficit* / 440**Glossary** / G-1**Index** / I-1

Chapter 35 *Trading with the World* 453

Silk Routes and Rust Belts / 454

Patterns and Trends in International Trade / 455

- U.S. international trade / 455
- Trends in trade / 457

Opportunity Cost and Comparative Advantage / 458

- Opportunity cost in Pioneerland / 458
- Opportunity cost in Magic Empire / 459
- Comparative advantage / 459

The Gains from Trade / 460

- The basic idea / 460
- Reaping the gains from trade / 460
- Balanced trade / 461
- Changes in production and consumption / 461
- Calculating the gains from trade / 462
- Gains for all / 463
- Absolute advantage / 463
- Gains from trade in reality / 463
- A puzzle / 464

Trade Restrictions / 465

- The history of tariffs / 465
- How tariffs work / 467
- Nontariff barriers / 471
- How quotas and VERs work / 471
- Why quotas and VERs might be preferred to tariffs / 473
- Dumping and countervailing duties / 473
- Why is international trade restricted? / 473
- Compensating losers / 474
- Political outcome / 474

Reading Between the Lines

Winners and Losers / 468

Chapter 36 *The Balance of Payments and the Dollar* 478

For Sale: America / 479

Financing International Trade / 480

- Balance of payments accounts / 480
- Borrowers and lenders, debtors and creditors / 483
- Current account balance / 483
- Bookkeeping and behavior / 485

Foreign Exchange and the Dollar / 487

- Foreign exchange regimes / 487
- Recent exchange rate history / 490
- Exchange rate determination / 492
- Why is the exchange rate so volatile? / 497

Arbitrage, Prices, and Interest Rates / 498

- Arbitrage / 498
- Purchasing power parity / 499
- Interest-rate parity / 500
- A world market / 505

Reading Between the Lines

The Making of a Mishmash / 448

Reading Between the Lines

Big Mac Currencies / 502

Chapter 37 Growth and Development 513*Feed the World* / 514**The International Distribution of Income / 515**

Poorest countries / 515

Developing countries / 516

Newly industrialized countries / 516

Industrial countries / 516

Oil-rich countries / 516

Communist countries / 516

The world Lorenz curve / 516

Growth Rates and Income Levels / 517**Inputs, Technological Progress, and Economic Growth / 519**

Capital accumulation / 520

Technological change / 520

Obstacles to Economic Growth / 521

Population growth / 521

Low saving rate / 523

International debt / 524

The underdevelopment trap / 525

Overcoming the Obstacles to Economic Development / 525

Population control / 525

Foreign aid / 525

Trade and development / 525

Aggregate demand stimulation and growth / 527

Reading Between the Lines*Deflation and Development* / 528**Chapter 38 Comparing Economic Systems 534***Perestroika* / 535**The Fundamental Economic Problem / 536**

Scarcity / 536

Getting onto the production possibility frontier / 536

Producing the right quantities of goods and services / 536

The distribution of economic well-being / 537

Alternative Economic Systems / 537

Capitalism / 538

Socialism / 539

The pros and cons of capitalism / 539

The Varieties of Capitalism / 540

Japan / 540

Welfare state capitalism / 541

The Soviet Union / 542

History / 542

Planning and command system / 543

China / 547

The Great Leap Forward / 547

1978 reforms / 548

Comparing Capitalism and Socialism / 549

Capitalism / 549

Socialism / 550

Market socialism / 551

Perestroika in the model economy / 551

Inefficiencies in capitalism / 551

Economic growth and average living standards / 551

Income inequality under the two systems / 553

Glossary / G-1**Index / I-1**