BRIEF CONTENTS

About the Authors x Preface xi Walk Through Tour xvi Supplements xviii Acknowledgements xx

PART 1 Introduction 1

- 1 Ten Principles of Economics 2
- **2** Thinking Like an Economist 21
- 3 Interdependence and the Gains from Trade 52

PART 2 Supply and Demand I: How Markets Work 67

4 The Market Forces of Supply and Demand 68

PART 3 The Data of Macroeconomics 95

- **5** Measuring a Nation's Income 96
- 6 Measuring the Cost of Living 116

PART 4 The Real Economy in the Long Run 133

- 7 Production and Growth 134
- 8 Saving, Investment and the Financial System 160
- **9** The Basic Tools of Finance 182
- 10 Unemployment 202

PART 5 Money and Prices in the Long Run 225

- 11 The Monetary System 226
- **12** Money Growth and Inflation 251

PART 6 The Macroeconomics of Open Economies 275

- 13 Open-economy Macroeconomics: Basic Concepts 276
- 14 A Macroeconomic Theory of the Open Economy 296

PART 7 Short-run Economic Fluctuations 315

- 15 Keynes and IS-LM Analysis 316
- 16 Aggregate Demand and Aggregate Supply 336
- 17 The Influence of Monetary and Fiscal Policy on Aggregate Demand .367
- 18 The Short-run Trade-off Between Inflation and Unemployment 392

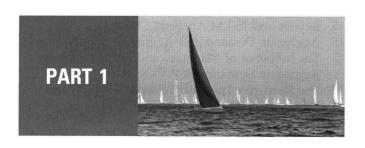
PART 8 Topics in International Finance and Macroeconomics 425

- **19** The Financial Crisis 426
- **20** Common Currency Areas and European Monetary Union 450

PART 9 Final Thoughts 477

21 Five Debates over Macroeconomic Policy 478

Glossary 493 Index 499 About the Authors x Preface xi Walk Through Tour xvi Supplements xviii Acknowledgements xx



INTRODUCTION 1

1 Ten Principles of Economics 2

How People Make Decisions 3
How People Interact 8
How the Economy as a Whole Works 12
Conclusion 17
Summary 18
Key Concepts 18
Questions for Review 18
Problems and Applications 19

2 Thinking Like an Economist 21

The Economist as Scientist 22
The Economist as Policy Advisor 31
Why Economists Disagree 35
Let's Get Going 39
Summary 40
Key Concepts 40
Questions for Review 41
Problems and Applications 41
Appendix Graphing: A Brief Review 42

3 Interdependence and the Gains from Trade 52

A Parable for the Modern Economy 53 The Principle of Comparative Advantage 57 Applications of Comparative Advantage 61 Conclusion 64
Summary 64
Key Concepts 64
Questions for Review 65
Problems and Applications 65



SUPPLY AND DEMAND I: HOW MARKETS WORK 67

4 The Market Forces of Supply and Demand 68

Markets and Competition 68

Demand 70

Supply 76

Supply and Demand Together 80

Conclusion: How Prices Allocate Resources 89

Summary 90

Key Concepts 91

Questions for Review 91

Problems and Applications 92



THE DATA OF MACROECONOMICS 95

5 Measuring a Nation's Income 96

The Economy's Income and Expenditure 97
The Measurement of Gross Domestic Product 99

The Components of GDP 102
Real Versus Nominal GDP 104
GDP and Economic Well-being 108
Conclusion 112
Summary 113
Key Concepts 113
Questions for Review 113
Problems and Applications 114

6 Measuring the Cost of Living 116

The Consumer Prices Index 117

Correcting Economic Variables for the Effects of Inflation 126

Conclusion 129

Summary 131

Key Concepts 131

Questions for Review 131

Problems and Applications 132



THE REAL ECONOMY IN THE LONG RUN 133

7 Production and Growth 134

Economic Growth Around the World 136
Productivity: Its Role and Determinants 140
Economic Growth and Public Policy 144
Conclusion: The Importance of Long-run
Growth 157
Summary 157
Key Concepts 158
Questions for Review 158
Problems and Applications 158

8 Saving, Investment and the Financial System 160

Financial Institutions in the Economy 161
Saving and Investment in the National Income
Accounts 168
The Market for Loanable Funds 171
Conclusion 178

Summary 179 Key Concepts 179 Questions for Review 180 Problems and Applications 180

9 The Basic Tools of Finance 182

Present Value: Measuring the Time Value of
Money 183

Managing Risk 185

Asset Valuation 192

Conclusion 199

Summary 199

Key Concepts 200

Questions for Review 200

Problems and Applications 200

10 Unemployment 202

Identifying Unemployment 203
Job Search 211
Minimum Wage Laws 215
Unions and Collective Bargaining 217
The Theory of Efficiency Wages 219
Conclusion 221
Summary 221
Key Concepts 222
Questions for Review 222
Problems and Applications 222



MONEY AND PRICES IN THE LONG RUN 225

11 The Monetary System 226

The Meaning of Money 227
The Role of Central Banks 232
The European Central Bank and the Eurosystem 234
The Bank of England 235
The Federal Reserve System 236
Banks and the Money Supply 237
Conclusion 247
Summary 248

Key Concepts 249 Questions for Review 249 Problems and Applications 249

12 Money Growth and Inflation 251

The Classical Theory of Inflation 253
The Costs of Inflation 263
Conclusion 271
Summary 272
Key Concepts 272
Questions for Review 272
Problems and Applications 273



THE MACROECONOMICS OF OPEN ECONOMIES 275

13 Open-economy Macroeconomics: Basic Concepts 276

The International Flows of Goods and Capital 277
The Prices for International Transactions: Real and
Nominal Exchange Rates 283
A First Theory of Exchange Rate Determination:
Purchasing Power Parity 286
Conclusion 293
Summary 293
Key Concepts 293
Questions for Review 294
Problems and Applications 294

14 A Macroeconomic Theory of the Open Economy 296

Supply and Demand for Loanable Funds and for Foreign Currency Exchange 297

Equilibrium in the Open Economy 301

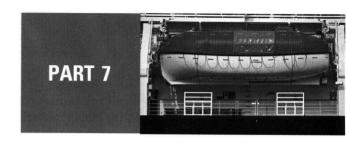
How Policies and Events Affect an Open Economy 304

Conclusion 312

Summary 312

Key Concepts 313

Questions for Review 313 Problems and Applications 313



SHORT-RUN ECONOMIC FLUCTUATIONS 315

15 Keynes and IS-LM Analysis 316

The Keynesian Cross 317
The Multiplier Effect 319
The IS and LM Curves 324
General Equilibrium Using the IS-LM Model
From IS-LM to Aggregate Demand 330
Conclusion 333
Summary 333
Key Concepts 334
Questions for Review 334
Problems and Applications 334

16 Aggregate Demand and Aggregate Supply 336

Three Key Facts about Economic Fluctuations 337
Explaining Short-run Economic Fluctuations 342
The Aggregate Demand Curve 344
The Aggregate Supply Curve 349
Two Causes of Economic Fluctuations 357
Conclusion 363
Summary 364
Key Concepts 364
Questions for Review 365
Problems and Applications 365

17 The Influence of Monetary and Fiscal Policy on Aggregate Demand 367

How Monetary Policy Influences Aggregate
Demand 368

How Fiscal Policy Influences Aggregate
Demand 378

Using Policy to Stabilize the Economy 382

Conclusion 388

Summary 389

Key Concepts 389 Questions for Review 390 Problems and Applications 390

18 The Short-run Trade-off Between Inflation and Unemployment 392

The Phillips Curve 393 Shifts in the Phillips Curve: The Role of Expectations 395 The Long-run Vertical Phillips Curve as an Argument for Central Bank Independence 403 Shifts in the Phillips Curve: The Role of Supply Shocks 407 The Cost of Reducing Inflation Inflation Targeting Conclusion 420 Summary 421 Key Concepts 421 Questions for Review 422 Problems and Applications 422



TOPICS IN INTERNATIONAL FINANCE AND MACROECONOMICS 425

19 THE FINANCIAL CRISIS 426

Asymmetric Information, the Bonus
Culture and Risk 430
The Bubble Bursts 432
The Path to Global Recession 434
Summary: The Causes of the Financial
Crisis 435
The Conduct of Monetary Policy 436
Lesson Learned? The Role of the Regulators 442
Conclusion 447
Summary 447

Key Concepts 448 Questions for Review 448 Problems and Applications 448

20 Common Currency Areas and European Monetary Union 450

The Euro 451
The Benefits and Costs of a Common Currency 454
The Theory of Optimum Currency Areas 459
Is Europe an Optimum Currency Area? 461
Fiscal Policy and Common Currency Areas 467
Conclusion 472
Summary 473
Key Concepts 474
Questions for Review 474
Problems and Applications 474



FINAL THOUGHTS 477

21 Five Debates over Macroeconomic Policy 478

If Only We Knew What We Know! 478
Are Structural Deficits Real or Not? 480
Should the Government Balance Its Budget? 482
Is Macroprudential Policy the 'Missing Ingredient' from the Current Policy Framework? 484
How Did Economists Get it So Wrong? 486
Conclusion 489
Summary 490
Questions for Review 490
Problems and Applications 491

Glossary 493 Index 499