SUMMARY

1. Microeconomics examines the functioning of individual industries and the behavior of individual decision-making units. Macroeconomics is concerned with the sum, or aggregate, of these individual decisions—the consumption of all households in the economy, the amount of labor supplied and demanded by all individuals and firms, and the total amount of all goods and services produced.

MACROECONOMIC CONCERNS p. 402

2. The three topics of primary concern to macroeconomists are the growth rate of aggregate output, the level of unemployment, and increases in the overall price level, or inflation.

THE COMPONENTS OF THE MACROECONOMY p. 404

3. The circular flow diagram shows the flow of income received and payments made by the four groups in the economy—households, firms, the government, and the rest of the world. Everybody's expenditure is someone else's receipt—every transaction must have two sides.

4. Another way of looking at how households, firms, the government, and the rest of the world relate is to consider the markets in which they interact: the goods-and-services market, labor market, and money (financial) market.

5. Among the tools that the government has available for influencing the macroeconomy are fiscal policy (decisions on...
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taxes and government spending) and monetary policy (control of the money supply, which affects interest rates).

A BRIEF HISTORY OF MACROECONOMICS p. 407

6. Macroeconomics was born out of the effort to explain the Great Depression of the 1930s. Since that time, the discipline has evolved, concerning itself with new issues as the problems facing the economy have changed. Through the late

1960s, it was believed that the government could “fine-tune” the economy to keep it running on an even keel at all times. The poor economic performance of the 1970s, however, showed that fine-tuning does not always work.

THE U.S. ECONOMY SINCE 1970 p. 410

7. Since 1970, the U.S. economy has seen four recessions and two periods of high inflation.

REVIEW TERMS AND CONCEPTS

aggregate behavior, p. 401
aggregate output, p. 402
business cycle, p. 402
circular flow, p. 405
circulation, recession, or slump, p. 402
corporate bonds, p. 407
deflation, p. 404
depression, p. 402
dividends, p. 407
expansion or boom, p. 402
fine-tuning, p. 402
fiscal policy, p. 408
Great Depression, p. 407
hyperinflation, p. 404
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monetary policy, p. 407
recession, p. 407
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stagflation, p. 408
sticky prices, p. 401
transfer payments, p. 405
Treasury bonds, notes, and bills, p. 407
unemployment rate, p. 403

PROBLEMS

Visit www.myeconlab.com to complete the problems marked in orange online. You will receive instant feedback on your answers, tutorial help, and access to additional practice problems.

1. Define inflation. Assume that you live in a simple economy in which only three goods are produced and traded: fish, fruit, and meat. Suppose that on January 1, 2007, fish sold for $2.50 per pound, meat was $3.00 per pound, and fruit was $1.50 per pound. At the end of the year, you discover that the catch was low and that fish prices had increased to $5.00 per pound, but fruit prices stayed at $1.50 and meat prices had actually fallen to $2.00. Can you say what happened to the overall “price level”? How might you construct a measure of the “change in the price level”? What additional information might you need to construct your measure?

2. Define unemployment. Should everyone who does not hold a job be considered “unemployed”? To help with your answer, draw a supply and demand diagram depicting the labor market. What is measured along the demand curve? What factors determine the quantity of labor demanded during a given period? What is measured along the labor supply curve? What factors determine the quantity of labor supplied by households during a given period? What is the opportunity cost of holding a job?

[Related to the Economics in Practice on p. 409] The Economics in Practice describes prosperity and recession as they are depicted in literature. At the beginning of 2008, there was a debate about whether the U.S. economy was in recession. Look at the data on real GDP growth and unemployment and describe the pattern since 2007. You can find raw data on employment and unemployment at www.bls.gov, and you can find raw data on real GDP growth at www.bea.gov. (In both cases, use the data described in “Current Releases.”) Summarize what happened during 2008. Did we have a recession? Explain.

4. A recession occurred in the U.S. economy during the first three quarters of 2001. National output of goods and services fell during this period. But during the fourth quarter of 2001, output began to increase and it increased at a slow rate through the first quarter of 2003. At the same time, between March 2001 and April 2003, employment declined almost continuously with a loss of over 2 million jobs. How is it possible that output rises while at the same time employment is falling?

5. Describe the economy of your state. What is the most recently reported unemployment rate? How has the number of payroll jobs changed over the last 3 months and over the last year? How does your state’s performance compare to the U.S. economy’s performance over the last year? What explanations have been offered in the press? How accurate are they?

6. Explain briefly how macroeconomics is different from microeconomics. How can macroeconomists use microeconomic theory to guide them in their work, and why might they want to do so?

7. During 1993 when the economy was growing very slowly, President Clinton recommended a series of spending cuts and tax increases designed to reduce the deficit. These were passed by Congress in the Omnibus Budget Reconciliation Act of 1993. Some who opposed the bill argue that the United States was pursuing a “contractionary fiscal policy” at precisely the wrong time. Explain their logic.
8. Many of the expansionary periods during the twentieth century occurred during wars. Why do you think this is true?

9. In the 1940s, you could buy a soda for 5 cents, eat dinner at a restaurant for less than $1, and purchase a house for $10,000. From this statement, it follows that consumers today are worse off than consumers in the 1940s. Comment.

10. [Related to Economics in Practice on p. 411] John Maynard Keynes was the first to show that government policy could be used to change aggregate output and prevent recessions by stabilizing the economy. Describe the economy of the world at the time Keynes was writing. Describe the economy of the United States today. What measures were being proposed by the Presidential candidates in the election of 2008 to prevent or end a recession in 2008–2009? Where the actions taken appropriate from the standpoint of John Maynard Keynes? Did they have the desired effect?

11. [Related to Economics in Practice on p. 413] Presidential elections are often influenced by the current state of the economy. The state of the U.S economy was a major campaign issue in the 2008 presidential election. Go to www.bls.gov to find the quarterly data on the unemployment rate in 2008, and www.bea.gov to find the quarterly GDP data for 2008. Based on this data, was the economy in a recession prior to the 2008 presidential election? Does there appear to be any link between the election results and the state of the economy? Briefly explain how the election results may or may not have been influenced by the state of the economy in 2008. For more information, see fairmodel.econ.yale.edu/vote2008/index2.htm.