Introduction to Macroeconomics

Agenda
• What Macroeconomics Is About.
• What Macroeconomists Do.
• Why Macroeconomists Disagree.

What Macroeconomics Is About
• Macroeconomics is the study of:

  1. The structure, dynamic adjustment, and performance of national economies, and
  2. The government policies that affect national economic performance.

What Macroeconomics Is About
• The main issues of macroeconomics are:
  – Long-run economic growth
  – Business cycles/fluctuations
  – Unemployment
  – Inflation
  – The international economy
  – Macroeconomic policy
What Macroeconomics Is About

• Long-run economic growth:
  – Figure 1.1: Output of the U.S. economy.

What Macroeconomics Is About

• Long-run Economic Growth:
  – Two main sources of growth.
    • Population growth.
    • Increases in average labor productivity.
  – Figure 1.2: Average labor productivity in the U.S.
    • Average labor productivity is output per unit of labor.
What Macroeconomics Is About

- Average labor productivity growth:
  - About 2.5% per year from 1949 to 1973.
  - About 1.1% per year from 1973 to 1995.
  - About 2.0% per year from 1995 to 2005.

What Macroeconomics Is About

- Business cycles or fluctuations:
  - Business cycles are the short-run contractions and expansions in economic activity.

What Macroeconomics Is About

- Unemployment:
  - Unemployment is the number of people who are available for work and actively seeking work but cannot find jobs.

  • Figure 1.3: The U.S. unemployment rate.
What Macroeconomics Is About

• Inflation:
  – Inflation is a persistent rise in the general price level.
    • Hyperinflation is an extremely high rate of inflation.
    • Deflation is a persistent decline in the general price level.
  – Figure 1-4: Consumer prices in the U.S.

What Macroeconomics Is About

• The international economy:
  – Open vs. closed economies:
    • An open economy has extensive trading and financial relationships with other national economies.
    • A closed economy has limited (or no) trading and financial relationships with other national economies.

• Trade imbalances are the differences between exports and imports:
  • Trade surplus occurs when exports exceed imports.
  • Trade deficit occurs when imports exceed exports.
  – Figure 1.5: U.S. exports and imports.
What Macroeconomics Is About

• Macroeconomic Policy:
  – Fiscal policy is the decisions made about the levels of government spending and tax rates.
  • Figure 1.6: Federal government spending and taxes.

• Monetary policy is the growth of money supply, determined by a nation’s central bank.
  • In the U.S., the Federal Reserve System or the Fed.
What Macroeconomics is About

- Aggregation:
  - Aggregation is the summing up of individual economic variables to obtain economy-wide totals.
  - This distinguishes microeconomics (disaggregated) from macroeconomics (aggregated).

What Macroeconomists Do

- Teaching macroeconomics.
- Macroeconomic forecasting.
- Macroeconomic analysis.
- Data development.
- Macroeconomic research.

What Macroeconomists Do

- Macroeconomic research:
  - The goal is to make general statements about how the macroeconomy works.
    - An economic theory is a set of ideas about the economy, organized in a logical framework.
    - An economic model is a simplified description of some aspect of the economy.

What Macroeconomists Do

- Usefulness of theory and models depends on:
  1. The reasonableness of assumptions.
  2. The possibility of being applied to real problems.
  3. Whether there are empirically testable implications.
  4. Whether the theoretical results are consistent with real-world data.
What Macroeconomists Do

• Developing and Testing Economic Theories:
  1. State the research question.
  2. Make provisional assumptions.
  3. Work out the implications of the theory.
  4. Conduct an empirical analysis.
  5. Evaluate the results.

Why Macroeconomists Disagree

• Policy Differences.
• Theoretical Differences.

Why Macroeconomists Disagree

• Policy Differences:
  – Economists may have different policy recommendations even if they agree on current economic conditions and the outlook for the economy.

Why Macroeconomists Disagree

• Policy Differences:
  – Positive vs. normative analysis:
    • Positive analysis examines the economic consequences of a policy.
    • Normative analysis determines whether a policy should be used.
Why Macroeconomists Disagree

• Theoretical Differences:
  – Classical economists and Keynesians economists have different views of the structure and dynamic adjustment of the economy.

Why Macroeconomists Disagree

• Classicals versus Keynesians:
  – The classical approach:
    • The economy works well on its own.
    • The “invisible hand” is the idea that if there are free markets and individuals conduct their economic affairs in their own best interests, the overall economy will work well.

Why Macroeconomists Disagree

• Classicals versus Keynesians:
  – In the classical approach:
    • Wages and prices adjust rapidly to get to equilibrium.
    • One conclusion is that the government should have only a limited role in the economy

Why Macroeconomists Disagree

• Classicals versus Keynesians:
  – The Keynesian approach:
    • Observed that during the Great Depression, the classical theory failed because of persistent high unemployment.
Why Macroeconomists Disagree

• Classicals versus Keynesians:
  – The Keynesian approach:
    • Keynes concluded that persistent unemployment occurred because wages and prices are slow to adjust so that markets can remain out of equilibrium for long periods.
    • One conclusion is that government should intervene to restore full employment more quickly.

• Evolution of the Classical-Keynesian debate:
  – Keynesians dominated from WWII to 1970.
  – Stagflation led a classical comeback in the 1970s.
  – Excellent research with both approaches since.

Preview: A Unified Approach

• A unified approach to macroeconomics:
  – A single model of the macroeconomy to present both classical and Keynesian ideas.
  – The model is built on 3 aggregate markets—the labor market, the goods market, the asset market.

Why Macroeconomists Disagree

• A unified approach to macroeconomics:
  – In the long run:
    • Classicals believe wages and prices are perfectly flexible.
    • Keynesians believe wages and prices are perfectly flexible.
  – In the short run:
    • Classicals assume flexible wages and prices.
    • Keynesians assume wages and prices are slow to adjust.