Learning objectives

This chapter introduces you to

- the issues macroeconomists study
- the tools macroeconomists use
- some important concepts in macroeconomic analysis
Important issues in macroeconomics

- Why does the cost of living keep rising?
- Why are millions of people unemployed, even when the economy is booming?
- Why are there recessions? Can the government do anything to combat recessions? Should it??
Important issues in macroeconomics

- What is the government budget deficit? How does it affect the economy?
- Why does the U.S. have such a huge trade deficit?
- Why are so many countries poor? What policies might help them grow out of poverty?
U.S. Gross Domestic Product
in billions of chained 1996 dollars

long-run upward trend...
U.S. Gross Domestic Product
in billions of chained 1996 dollars

longest economic expansion on record

Recessions

CHAPTER 1 The Science of Macroeconomics
Unemployment and social problems

Each one-point increase in the unemployment rate is associated with:

- 920 more suicides
- 650 more homicides
- 4000 more people admitted to state mental institutions
- 3300 more people sent to state prisons
- 37,000 more deaths
- increases in domestic violence and homelessness
Unemployment and earnings growth

![Graph showing the growth rate of inflation-adjusted hourly earnings and the change in Unemployment rate from 1965 to 2000. The graph includes blue and red lines representing the two metrics, with the y-axis ranging from -5 to 5%.]

- Blue line: Growth rate of inflation-adjusted hourly earnings
- Red line: Change in Unemployment rate

CHAPTER 1 The Science of Macroeconomics
### Inflation and Unemployment in Election Years

<table>
<thead>
<tr>
<th>Year</th>
<th>U Rate</th>
<th>Inflation Rate</th>
<th>Election Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>7.7%</td>
<td>5.8%</td>
<td>Carter (D)</td>
</tr>
<tr>
<td>1980</td>
<td>7.1%</td>
<td>13.5%</td>
<td>Reagan (R)</td>
</tr>
<tr>
<td>1984</td>
<td>7.5%</td>
<td>4.3%</td>
<td>Reagan (R)</td>
</tr>
<tr>
<td>1988</td>
<td>5.5%</td>
<td>4.1%</td>
<td>Bush I (R)</td>
</tr>
<tr>
<td>1992</td>
<td>7.5%</td>
<td>3.0%</td>
<td>Clinton (D)</td>
</tr>
<tr>
<td>1996</td>
<td>5.4%</td>
<td>3.3%</td>
<td>Clinton (D)</td>
</tr>
<tr>
<td>2000</td>
<td>4.0%</td>
<td>3.4%</td>
<td>Bush II (R)</td>
</tr>
</tbody>
</table>
Prices: Flexible Versus Sticky

- **Market clearing**: an assumption that prices are flexible and adjust to equate supply and demand.

- In the short run, many prices are **sticky**---they adjust only sluggishly in response to supply/demand imbalances.
  
  For example,
  
  - labor contracts that fix the nominal wage for a year or longer
  - magazine prices that publishers change only once every 3-4 years
Prices: Flexible Versus Sticky

- The economy’s behavior depends partly on whether prices are sticky or flexible:

- If prices are sticky, then demand won’t always equal supply. This helps explain
  - unemployment (excess supply of labor)
  - the occasional inability of firms to sell what they produce

- Long run: prices flexible, markets clear, economy behaves very differently.
Outline of this book:

- Introductory material (chaps. 1 & 2)
- **Classical Theory** (chaps. 3-6)
  How the economy works in the long run, when prices are flexible
- **Growth Theory** (chaps. 7-8)
  The standard of living and its growth rate over the very long run
- **Business Cycle Theory** (chaps 9-13)
  How the economy works in the short run, when prices are sticky.
Outline of this book:

- **Policy debates** (Chaps. 14-15)
  Should the government try to smooth business cycle fluctuations? Is the government’s debt a problem?

- **Microeconomic foundations** (Chaps. 16-19)
  Insights from looking at the behavior of consumers, firms, and other issues from a microeconomic perspective.