Macroeconomics

MACROECONOMICS

An Introductory Text

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B.Sc. Econ.

M
MACMILLAN

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Preface

Intended Readership

Until recently most standard A-level economics textbooks have tried to incorporate both the microeconomics section and the macroeconomics section of the syllabus under the single heading of economics. In the past the examination boards have given the greatest weight to the microeconomics side and this has led to a tendency for authors to deal with macroeconomics almost as an after-thought. Today the emphasis has changed, and the two sections are treated much more equally. It is therefore no longer appropriate that macroeconomics should be something that is just tacked on the end of a general textbook. Both the syllabus and the examinations require something more detailed. This textbook is designed to fill that new requirement.

The contents have been decided on the basis of both the current examination requirements and the likely future developments. Because of its introductory nature this book is also suitable for the first-year university degree courses, and for other courses which require a fairly wide introduction to macroeconomics.

The Order of the Book

Economics stands out among the social sciences as being the one that relies most on logic. The theories of economics develop out of what has gone before, and they create what will follow. The order in which this book is presented follows a similar logic so that the reader may work from one section to the next.

Preliminary knowledge

Macroeconomics deals with how all the sections of the economy work together,

how they interact, and how they influence each other. Before it is possible to study the macroeconomy in detail, it is therefore necessary to know how the microeconomic systems work. As this textbook deals with only macroeconomics, it is assumed that the reader will already be familiar with the theories and concepts of microeconomics. The most important of these for our purposes is the use of supply and demand analysis to determine price and quantity.

The main text

The order of the main text is based on the assumption that you cannot discuss theories of the whole economy until you have a whole economy to discuss them about. The National Income Statistics are therefore presented at the beginning (Chapter 2). These form the real life data on which the theories are based and tested. The theories themselves are outlined following the order of their development from Classical to Keynesian and on to the present schools of thought, such as Monetarism (Chapters 3 and 4, and later). To justify these theories and to show how they explain the working of the economy it is necessary to deal with investment, consumption, savings, interest and income. These make up the engine that allows the economy to run (Chapters 5, 6, 7 and 8).

Under the Classical economists it was thought that the economy was like a train, running along fairly straight lines, which would take us safely along the track of growth and prosperity, as long as we did not interfere with it. Today most economists accept that it is not that simple, either because the interference has already occurred, or because the train was always faced with a choice of lines down which it might at any time suddenly swerve. We therefore need a driver, the government, to keep us on the right track. The controls available to the driver are those of fiscal, monetary and physical policies (Chapters 9, 10 and 11).

As with conventional trains there is of course a destination for our economic locomotive. For macroeconomics this is expressed in terms of the major economic objectives of low inflation, full employment, a favourable balance of payments, and growth (Chapters 12, 13, 14 and 15). As this is only an introductory text the theories have been kept simple. The final chapter (Chapter 16) gives a brief glimpse into the complexities of the real world.

Reference material

Many topics have, by necessity, been covered only briefly, and a full reference section is therefore given at the end of the book for each chapter. These references have been selected to give fuller details where the topics need to be developed further. This is particularly the case with Applied Economics, which is not covered in this book. The references also cite texts and articles which explain further the theories and data presented in this book, and develop them beyond the introductory stage.

Examination Questions

In compiling a list of essay and data response questions for each chapter I have strayed from the convention of simply reproducing passed examination questions. This has been done for three reasons:

1. The majority of readers, sitting a specific examination, will already have copies of their own board's passed papers, so that reproducing them again is unnecessary duplication.
2. With rare exceptions examination boards do not reproduce exactly the same questions, although they do change them slightly and set them again.
3. Examination boards are always looking for new questions and the more practice the examinee can get of different questions the better.

I have therefore compiled my questions on the basis of passed examination questions, but at the same time trying to vary them and introduce new angles. As with all good questions it is hoped that they will be suitable for different levels of study and skill, allowing for basic answers and more developed answers in response to the same question.

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In writing a textbook of this general nature one inevitably relies very heavily upon the work of others. I am most grateful, and appreciative, of the hard work of other writers on whose expertise I have drawn. I would particularly like to thank the Controller of Her Majesty's Stationery Office for permission to reproduce extracts of tables from *National Income and Expenditure 1983 Edition*. In choosing the relevant material I have been greatly helped by the advice and comments of colleagues. Any errors, however, remain the responsibility of the author. I would finally like to thank my wife, Sheila, for her support during the long hours of research and writing and for her invaluable aid in typing the final manuscript.

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Abbreviations

AMD	aggregate monetary demand
AMS	aggregate monetary supply
APC	average propensity to consume
APS	average propensity to save
C	consumption
CCC	Competition and Credit Control
E	exports
ECU	European currency unit
EEC	European Economic Community
EMS	European Monetary System
G	government expenditure
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GNE	gross national expenditure
GNP	gross national product
GNY	gross national income
i	interest rate
I	investments
IMF	International Monetary Fund
K	the multiplier
LP	liquidity preference
M	imports
M	money supply (when used with V)
MEC	marginal efficiency of capital
MLR	minimum lending rate
MPC	marginal propensity to consume
MPS	marginal propensity to save
NNP	net national product
OMO	open market operations
OPEC	Organisation of Petroleum Exporting Countries

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P	general price level (in $MV = PT$)
PSBR	public sector borrowing requirement
Q	quantity of goods and services (in $MV = PQ$)
RPI	retail price index
S	savings
SDRs	special drawing rights
T	transactions (in $MV = PT$)
V	velocity of circulation
VAT	Value Added Tax
Y	income

These abbreviations occur most frequently in the text. Other abbreviations will be explained in the sections in which they occur.