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Principles of Macroeconomics 9e

Mankiw



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Principles of Macroeconomics: a Guided Tour

INTRODUCTION

- 1 Ten Principles of Economics ————— *The study of economics is guided by a few big ideas.*
- 2 Thinking Like an Economist ————— *Economists view the world as both scientists and policymakers.*
- 3 Interdependence and the Gains from Trade ——— *The theory of comparative advantage explains how people benefit from economic interdependence.*

HOW MARKETS WORK

- 4 The Market Forces of Supply and Demand ———
 - 5 Elasticity and Its Application —————
 - 6 Supply, Demand, and Government Policies ———
- How does the economy coordinate interdependent economic actors? Through the market forces of supply and demand.*
- The tools of supply and demand are put to work to examine the effects of various government policies.*

MARKETS AND WELFARE

- 7 Consumers, Producers, and the Efficiency of Markets ———
 - 8 Application: The Costs of Taxation —————
 - 9 Application: International Trade —————
- Why is the equilibrium of supply and demand desirable for society as a whole? The concepts of consumer and producer surplus explain the efficiency of markets, the costs of taxation, and the benefits of international trade.*

THE DATA OF MACROECONOMICS

- 10 Measuring a Nation's Income —————
 - 11 Measuring the Cost of Living —————
- The overall quantity of production and the overall price level are used to monitor developments in the economy as a whole.*

THE REAL ECONOMY IN THE LONG RUN

- 12 Production and Growth
- 13 Saving, Investment, and the Financial System
- 14 The Basic Tools of Finance
- 15 Unemployment

These chapters describe the forces that in the long run determine key real variables, including GDP growth, saving, investment, real interest rates, and unemployment.

MONEY AND PRICES IN THE LONG RUN

- 16 The Monetary System
- 17 Money Growth and Inflation

The monetary system is crucial in determining the long-run behavior of the price level, the inflation rate, and other nominal variables.

THE MACROECONOMICS OF OPEN ECONOMIES

- 18 Open-Economy Macroeconomics:
Basic Concepts
- 19 A Macroeconomic Theory of the
Open Economy

A nation's economic interactions with other nations are described by its trade balance, net foreign investment, and exchange rate.

A long-run model of the open economy explains the determinants of the trade balance, the real exchange rate, and other real variables.

SHORT-RUN ECONOMIC FLUCTUATIONS

- 20 Aggregate Demand and Aggregate Supply
- 21 The Influence of Monetary and Fiscal Policy
on Aggregate Demand
- 22 The Short-Run Trade-Off between
Inflation and Unemployment

The model of aggregate demand and aggregate supply explains short-run economic fluctuations, the short-run effects of monetary and fiscal policy, and the short-run linkage between real and nominal variables.

FINAL THOUGHTS

- 23 Six Debates over Macroeconomic Policy

A capstone chapter presents both sides of six major debates over economic policy.

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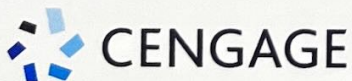


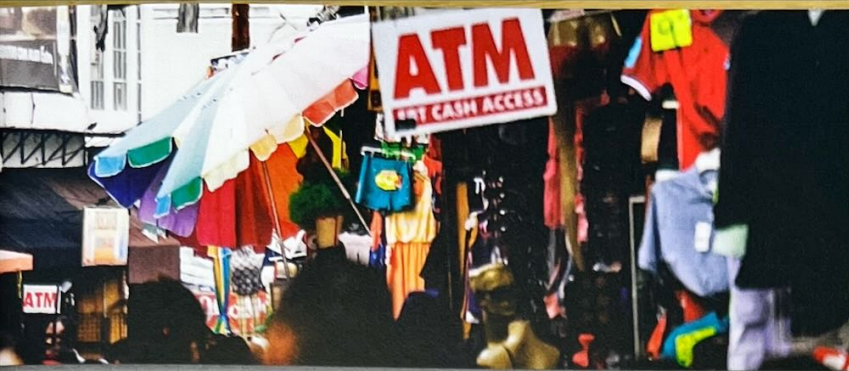
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Preface: To the Instructor

During my 20-year career as a student, the course that excited me most was the two-semester sequence on the principles of economics that I took during my freshman year in college. It is no exaggeration to say that it changed my life.

I had grown up in a family that often discussed politics over the dinner table. The pros and cons of various solutions to society's problems generated fervent debate. But in school, I had been drawn to the sciences. Whereas politics seemed vague, rambling, and subjective, science was analytic, systematic, and objective. While political debate continued without end, science made progress.

My freshman course on the principles of economics opened my eyes to a new way of thinking. Economics combines the virtues of politics and science. It is, truly, a social science. Its subject matter is society—how people choose to lead their lives and how they interact with one another—but it approaches the subject with the dispassion of a science. By bringing the methods of science to the questions of politics, economics tries to make progress on the challenges that all societies face.

I was drawn to write this book in the hope that I could convey some of the excitement about economics that I felt as a student in my first economics course. Economics is a subject in which a little knowledge goes a long way. (The same cannot be said, for instance, of the study of physics or the Chinese language.) Economists have a unique way of viewing the world, much of which can be taught in one or two semesters. My goal in this book is to transmit this way of thinking to the widest possible audience and to convince readers that it illuminates much about the world around them.

I believe that everyone should study the fundamental ideas that economics has to offer. One purpose of general education is to inform people about the world and thereby make them better citizens. The study of economics, as much as any discipline, serves this goal. Writing an economics textbook is, therefore, a great honor and a great responsibility. It is one way that economists can help promote better government and a more prosperous future. As the great economist Paul Samuelson put it, "I don't care who writes a nation's laws, or crafts its advanced treaties, if I can write its economics textbooks."

What's New in the Ninth Edition?

Economics is fundamentally about understanding the world in which we live. Most chapters of this book include Case Studies illustrating how the principles of economics can be applied. In addition, In the News boxes offer excerpts from newspapers, magazines, and online news sources showing how economic ideas shed light on current issues facing society. After students finish their first course in economics, they should think about news stories from a new perspective and

with greater insight. To keep the study of economics fresh and relevant for each new cohort of students, I update each edition of this text to keep pace with the ever-changing world.

The new applications in this ninth edition are too numerous to list in their entirety, but here is a sample of the topics covered (and the chapters in which they appear):

- Technology companies are increasingly using economists to better run their businesses. (Chapter 2)
- The hit Broadway show *Hamilton* has brought renewed attention to the issue of ticket reselling. (Chapter 7)
- President Trump has taken a new and controversial approach to international trade. (Chapter 9)
- The theory of economic growth can help explain why so many of the world's poorest nations are in sub-Saharan Africa. (Chapter 12)
- Economist Martin Feldstein explains why the United States is so prosperous. (Chapter 12)
- Cryptocurrencies may be the money of the future, or they may be a passing fad. (Chapter 16)
- Living during a hyperinflation, such as the recent situation in Venezuela, is a surreal experience. (Chapter 17)
- Recent discussion of trade deficits has included a lot of misinformation. (Chapter 19)
- The Federal Reserve has started to reassess what it means to target an inflation rate of 2 percent. (Chapter 23)

In addition to updating the book, I have refined its coverage and pedagogy with input from many users of the previous edition. There are numerous changes, large and small, aimed at making the book clearer and more student-friendly.

All the changes that I made, and the many others that I considered, were evaluated in light of the benefits of brevity. Like most things that we study in economics, a student's time is a scarce resource. I always keep in mind a dictum from the great novelist Robertson Davies: "One of the most important things about writing is to boil it down and not bore the hell out of everybody."

How Is This Book Organized?

The organization of this book was designed to make economics as student-friendly as possible. What follows is a whirlwind tour of this text. The tour will, I hope, give instructors some sense of how the pieces fit together.

Introductory Material

Chapter 1, "Ten Principles of Economics," introduces students to the economist's view of the world. It previews some of the big ideas that recur throughout economics, such as opportunity cost, marginal decision making, the role of incentives, the gains from trade, and the efficiency of market allocations. Throughout the book, I refer regularly to the *Ten Principles of Economics* introduced in Chapter 1 to remind students that these ideas are the foundation for all economics.

Chapter 2, "Thinking Like an Economist," examines how economists approach their field of study. It discusses the role of assumptions in developing a theory and introduces the concept of an economic model. It also explores the role of economists in making policy. This chapter's appendix offers a brief refresher course on how graphs are used, as well as how they can be abused.

Chapter 3, "Interdependence and the Gains from Trade," presents the theory of comparative advantage. This theory explains why individuals trade with their neighbors, as well as why nations trade with other nations. Much of economics is about how market forces coordinate many individual production and consumption decisions. As a starting point for this analysis, students see in this chapter why specialization, interdependence, and trade can benefit everyone.

The Fundamental Tools of Supply and Demand

The next three chapters introduce the basic tools of supply and demand. Chapter 4, "The Market Forces of Supply and Demand," develops the supply curve, the demand curve, and the notion of market equilibrium. Chapter 5, "Elasticity and Its Application," introduces the concept of elasticity and uses it to analyze events in three different markets. Chapter 6, "Supply, Demand, and Government Policies," uses these tools to examine price controls, such as rent-control and minimum-wage laws, and tax incidence.

Chapter 7, "Consumers, Producers, and the Efficiency of Markets," extends the analysis of supply and demand using the concepts of consumer surplus and producer surplus. It begins by developing the link between consumers' willingness to pay and the demand curve and the link between producers' costs of production and the supply curve. It then shows that the market equilibrium maximizes the sum of the producer and consumer surplus. Thus, students learn early about the efficiency of market allocations.

The next two chapters apply the concepts of producer and consumer surplus to questions of policy. Chapter 8, "Application: The Costs of Taxation," shows why taxation results in deadweight losses and what determines the size of those losses. Chapter 9, "Application: International Trade," considers who wins and who loses from international trade and presents the debate over protectionist trade policies.

Macroeconomics

My overall approach to teaching macroeconomics is to examine the economy in the long run (when prices are flexible) before examining the economy in the short run (when prices are sticky). I believe that this organization simplifies learning macroeconomics for several reasons. First, the classical assumption of price flexibility is more closely linked to the basic lessons of supply and demand, which students have already mastered. Second, the classical dichotomy allows the study of the long run to be broken up into several easily digested pieces. Third, because the business cycle represents a transitory deviation from the economy's long-run growth path, studying the transitory deviations is more natural after the long-run equilibrium is understood. Fourth, the macroeconomic theory of the long run is less controversial among economists than is the macroeconomic theory of the short run. For these reasons, most upper-level courses in macroeconomics now follow this long-run-before-short-run approach; my goal is to offer introductory students the same advantage.

I start the coverage of macroeconomics with issues of measurement. Chapter 10, "Measuring a Nation's Income," discusses the meaning of gross domestic product and related statistics from the national income accounts. Chapter 11, "Measuring the Cost of Living," examines the measurement and use of the consumer price index.

The next four chapters describe the behavior of the real economy in the long run. Chapter 12, "Production and Growth," examines the determinants of the large variation in living standards over time and across countries. Chapter 13, "Saving, Investment, and the Financial System," discusses the types of financial institutions in our economy and examines their role in allocating resources. Chapter 14, "The Basic Tools of Finance," introduces present value, risk management, and asset pricing. Chapter 15, "Unemployment," considers the long-run determinants of the unemployment rate, including job search, minimum-wage laws, the market power of unions, and efficiency wages.

Having described the long-run behavior of the real economy, the book then turns to the long-run behavior of money and prices. Chapter 16, "The Monetary System," introduces the economist's concept of money and the role of the central bank in controlling the quantity of money. Chapter 17, "Money Growth and Inflation," develops the classical theory of inflation and discusses the costs that inflation imposes on a society.

The next two chapters present the macroeconomics of open economies, maintaining the long-run assumptions of price flexibility and full employment. Chapter 18, "Open-Economy Macroeconomics: Basic Concepts," explains the relationship among saving, investment, and the trade balance, the distinction between the nominal and real exchange rate, and the theory of purchasing-power parity. Chapter 19, "A Macroeconomic Theory of the Open Economy," presents a classical model of the international flow of goods and capital. The model sheds light on various issues, including the link between budget deficits and trade deficits and the macroeconomic effects of trade policies. Because instructors differ in their emphasis on this material, these chapters are written so they can be used in different ways. Some may choose to cover Chapter 18 but not Chapter 19; others may skip both chapters; and still others may choose to defer the analysis of open-economy macroeconomics until the end of their courses.

After developing the long-run theory of the economy in Chapters 12 through 19, the book turns to explaining short-run fluctuations around the long-run trend. Chapter 20, "Aggregate Demand and Aggregate Supply," begins with some facts about the business cycle and then introduces the model of aggregate demand and aggregate supply. Chapter 21, "The Influence of Monetary and Fiscal Policy on Aggregate Demand," explains how policymakers can use the tools at their disposal to shift the aggregate-demand curve. Chapter 22, "The Short-Run Trade-Off between Inflation and Unemployment," explains why policymakers who control aggregate demand face a trade-off between inflation and unemployment. It examines why this trade-off exists in the short run, why it shifts over time, and why it does not exist in the long run.

The book concludes with Chapter 23, "Six Debates over Macroeconomic Policy." This capstone chapter considers six controversial issues facing policymakers: the proper degree of policy activism in response to the business cycle, the relative efficacy of government spending hikes and tax cuts to fight recessions, the choice between rules and discretion in the conduct of monetary policy, the desirability of reaching zero inflation, the importance of balancing the government's budget, and the need for tax reform to encourage saving. For each issue, the chapter presents both sides of the debate and encourages students to make their own judgments.