Figure 1.1 Output of the U.S. economy, 1869–2002
Figure 1.2  Average labor productivity in the United States, 1900–2002
Figure 1.3  The U.S. unemployment rate, 1890–2002
Figure 1.4 Consumer prices in the United States
Figure 1.5  U.S. exports and imports, 1869–2002
Figure 1.6 U.S. Federal government spending and tax collections, 1869–2002
THE BIG QUESTIONS

• Thinking about the economy *as a whole*. General equilibrium.

• What determines long-run economic growth? Can government policy help to change growth rates?

  “Half of the population of sub-Saharan Africa lives in absolute poverty. And, uniquely, Africa is getting poorer. Average income per head is lower now than it was 30 years ago.”


• Why does the unemployment rate fluctuate so much? What are the causes of business cycles? Can government policy help to stabilize the macroeconomy? Who benefits and who loses from such policy?
• What causes inflation? Who benefits and who loses from inflation? Can central banks control inflation?

• What are the effects of the current huge U.S. government budget deficits? Should Social Security be reformed, and if so, how? Who benefits and who loses from reform?

• What are the effects of the current large U.S. trade deficits? Will the dollar continue to fall in value? Who benefits and who loses from large changes in the exchange rate?
A MODEL OF THE MACROECONOMY

• Three markets: labor, goods, and assets (money and bonds).

• Three prices: the wage, the price level, and the interest rate.

• Three equations:
  1. The aggregate supply curve (equilibrium in the labor market).
  2. The IS curve (equilibrium in the goods market).
  3. The LM curve (equilibrium in the asset market).

• Keynesian vs. New Classical: How quickly does the economy adjust to shocks?
LEADING KEYNESIAN MACROECONOMISTS

John Maynard Keynes (1883–1946)
Created the field of macroeconomics with the publication of *The General Theory of Employment, Interest, and Money* in 1936.

Sir John Hicks (1904–1989)
Nobel Prize winner in 1972. Developed the *IS-LM* model as a way of explaining Keynes’ ideas.

James Tobin (1918–2002)
Nobel Prize winner in 1981. Leader in the neo-classical synthesis, which tried to reconcile Keynesian macroeconomics with modern microeconomic theory.
[T]he ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. (…) [S]oon or late, it is ideas, not vested interests, which are dangerous for good or evil.

*J.M. Keynes*, The General Theory, 1936

If economists could manage to get themselves thought of as humble, competent people on a level with dentists, that would be splendid.

*J.M. Keynes*
LEADING NEW CLASSICAL MACROECONOMISTS

Robert E. Lucas, Jr.
Thomas J. Sargent

Finn E. Kydland
Edward C. Prescott
Is there some action a government of India could take that would lead the Indian economy to grow like Indonesia’s or Egypt’s? If so, what exactly? If not, what is it about the “nature of India” that makes it so? The consequences for human welfare involved in questions like these are simply staggering: Once one starts to think about them, it is hard to think of anything else.

Can these two paragraphs be viewed as a summary of things that are known about economic growth? After all, they are simply a sketch of some of the properties of mathematical models, purely fictional worlds, that certain economists have invented. How does one acquire knowledge about reality by working in one’s office with pen and paper? (...) [I] think this inventive, model-building process we are engaged in is an essential one . . . . If we understand the process of economic growth—or anything else—we ought to be capable of demonstrating this knowledge by creating it in these pen and paper (and computer-equipped) laboratories of ours. If we know what an economic miracle is, we ought to be able to make one.

R.E. Lucas, Jr., “Making a Miracle”, 1993
To apply the knowledge we have gained about depressions in Kennywood Park, we must be willing to argue by analogy from what we know about one situation to what we would like to know about another, quite different situation. And, as we all know, the analogy that one person finds persuasive, his neighbor may well find ridiculous. (…) I don’t know what one can do about it, except keep trying to tell better and better stories, to provide the raw material for better and more instructive analogies. How else can we free ourselves from the limits of historical experience so as to discover ways in which our society can operate better than it has in the past? In any case, that is what economists do. We are storytellers, operating much of the time in worlds of make believe. We do not find that the realm of imagination and ideas is an alternative to, or a retreat from, practical reality. On the contrary, it is the only way we have found to think seriously about reality.