1.1 What Is Macroeconomics?

- In this chapter, we learn:
  - What macroeconomics is and consider some questions.
  - How macroeconomics uses models, and why.
  - The book’s basic three-part structure: the long run, the short run, and issues for the future.

- The difference between macro- and microeconomics:
  - Macroeconomics
    - studies collections of people and firms, and how their interactions through markets determine the overall economic activity in a country or region.
    - “the big picture”
  - Microeconomics
    - focuses on the study of individual people, firms, or markets.

- Important macroeconomic questions to consider:
  - Why is today’s average American more than 10 times richer than 100 years ago?
  - 50 times richer than the average Ethiopian?
  - Do we understand and know the causes of
    - the recent global financial crisis?
    - the Great Recession?
    - the European debt crisis of recent years?
  - What role do stock markets play in the economy? What is a “bubble”?
• Topics studied in macroeconomics
  
  – The unemployment rate
  • fraction of the labor force that wants work but does not currently have a job.
  – The inflation rate
  • rate at which prices are increasing in an economy.
  – Government use of policy to direct or stabilize the economy
  • fiscal policy
  • monetary policy

• Topics studied in macroeconomics (continued)

  – Budget deficit
  • government borrows money to finance spending.
  • occurs if (Government spending) > (Tax revenues)

  – Trade deficits
  • occur when one economy borrows from another. This happens on an international level.
1.2 How Macroeconomics Studies Key Questions

- Macroeconomists have a general approach to study questions of interest:
  - Document the facts
  - Develop a model
  - Compare predictions of the model with original facts
  - Use the model to make other predictions that will eventually be tested

• Models
  - Models simplify the complicated real world into its most relevant elements.
  - A model is useful if it has good predictive power.
  - Economic models often involve systems of multiple equations.

• Parts of an economic model
  - Parameter
    - an input that is fixed over time, except when the model builder changes it for an experiment.
  - Exogenous variable
    - an input that can change over time, but determined ahead of time by the model builder.
    - exogenous = “outside of the model”
  - Endogenous variable
    - an outcome of the model—something that is explained by the model.
    - endogenous = “within the model”
• Suppose we have a working model. How can we use it?
  – Change parameters and exogenous variables to see how they affect endogenous variables.
  – Predict costs and benefits of new government policies.

1.3 An Overview of the Book

The Long Run
• Income per person in the United States
  – $2,800 in 1870
  – $44,000 in 2012
  – Many countries have not experienced similar increases in living standards.
• The analysis of economic growth helps explain the long run.

The Short Run
• Potential output
  – Measure of how per capita GDP would evolve with completely flexible prices and fully employed resources.
  – In 1982, actual output was five percent less than potential output.
  – Deviations in actual and potential output usually last only a short time.
• Long-term growth dominates short run fluctuations.

Issues for the Future
• Major decisions about government spending and taxes will need to be made.
• The United States is a large player in the world economy, and many economic decisions affect every country in the world.

Summary: Chapter 1
• Macroeconomics studies economy-wide data and trends.
• Many of the most important questions in economics require macroeconomic analysis. The answers to these questions can shape future policy.
• Macroeconomics studies questions by developing models with predictive power.

• A model is a collection of mathematical equations that are used to study a particular economic issue.

• Models determine the value of endogenous variables as functions of parameters and exogenous variables.

• The textbook focuses on the long run, the short run, and important concepts of future concern, respectively.
  
  – Figure 1.7 is a key graph for understanding macroeconomics.

This concludes the Lecture Slide Set for Chapter 1

**Macroeconomics**

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