Chapter 6: Macroeconomics: The Big Picture

Suggested Problems: Problems – 1, 2, 3, 4, 6

- 1. Which of the following questions are relevant for the study of macroeconomics and which for microeconomics?
- a. How will Ms. Martin's tips change when a large manufacturing plant near the restaurant where she works closes?
- b. What will happen to spending by consumers when the economy enters a downturn?
- c. How will the price of oranges change when a late frost damages Florida's orange groves?
- d. How will wages at a manufacturing plant change when its workforce is unionized?
- e. What will happen to U.S. exports as the dollar becomes less expensive in terms of other currencies?
- f. What is the relationship between a nation's unemployment rate and its inflation rate?
- a. This is a microeconomic question because it addresses the effects of a single firm's actions (the closure of a manufacturing plant) on a single individual (the waitress).
- b. This is a macroeconomic question because it considers how overall spending by consumers is affected by the state of the macroeconomy.
- c. This is a microeconomic question because it looks at how a single market (oranges) will be affected by a late frost.
- d. This is a microeconomic question because it addresses how wages in a particular plant will change when the firm's workforce is unionized.
- e. This is a macroeconomic question because it considers the change in the overall level of exports as the value of the dollar changes.
- f. This is a macroeconomic question because it addresses the relationship between two aggregate measures of economic activity: inflation and unemployment.
- 2. When one person saves, that person's wealth is increased, meaning that he or she can consume more in the future. But when everyone saves, everyone's income falls, meaning that everyone must consume less today. Explain this seeming contradiction.

This question concerns the paradox of thrift; what is true for an individual—that saving makes you better off—is not always true for the economy as a whole. When an individual saves, that person adds to his or her wealth, providing for higher consumption in the future. However, if everyone saves, firms will not sell as much and will lay off workers. Individuals find that their incomes fall as a result. So they must consume less today.

- 3. Before the Great Depression, the conventional wisdom among economists and policy makers was that the economy is largely self-regulating.
- a. Was this view consistent or inconsistent with Keynesian economics? Explain.
- b. What effect did the Great Depression have on conventional wisdom?
- c. Contrast the response of policy makers during the 2001 recession to the actions of policy makers during the Great Depression. What would have been the likely outcome of the 2001 recession if policy makers had responded in the same fashion as policy makers during the Great Depression?
- a. The view that the economy is largely self-regulating was at odds with Keynesian economics, which claimed that managing the economy, via the tools of fiscal and monetary policy, is the government's responsibility.
- b. The Great Depression was such a catastrophic occurrence that it shifted the conventional wisdom away from the view that the economy is largely self-regulating to the Keynesian view that the government should intervene to manage the economy.
- c. The policy makers of 2001 actively used monetary and fiscal policy to boost the economy. If they had done nothing, as policy makers did during the Great Depression, it is very likely that the recession of 2001 would have been much longer and deeper.
- 4. How do economists in the United States determine when a recession begins and when it ends? How do other countries determine whether or not a recession is occurring?

In the United States, economists assign the task of identifying recessions to an independent panel of experts at the National Bureau of Economic Research that determines when a recession begins and when it ends. They make this determination by looking at a variety of economic indicators, with the main focus on employment and production. In many other countries, economists adopt the rule that a recession is a period of at least two consecutive quarters during which the overall output of the economy shrinks.

6. The accompanying figure shows the annual rate of growth in employment for the United Kingdom and Japan from 1988 to 2005. (The annual growth

rate is the per- cent change in each year's employment over the previous year.)

- a. Comment on the business cycles of these two economies. Are their business cycles similar or dissimilar?
- b. Use the accompanying figure and the figure in the Global Comparison on inter- national business cycles in the chapter to compare the business cycles of each of these two economies with those of the United States and the eurozone.
- a. Japan and the United Kingdom do not appear to have similar business cycles. While employment was falling in the United Kingdom in the early 1990s, growth in employment was positive in Japan. The reverse occurred in the late 1990s.
- b. The United Kingdom appears to have a business cycle similar to those of both the United States and the eurozone. In the early 1990s, all three economies suffered negative growth rates in employment. They also experienced relatively low or negative growth in employment in 2001. Japan, however, had positive employment growth in the early 1990s and negative growth in the late 1990s when the other three economies seemed to be booming.