

# Detailed Table of Contents

Preface xiii

Guided tour xx

Technology to enhance learning and teaching xxii

Acknowledgements xxiv

**Chapter 1** Macroeconomics for the long run and for the short run 1

1.1. What is macroeconomics? 1

1.2. Long-run and short-run economic phenomena 4

1.3. Macroeconomic theory for the short run 7

1.4. Macroeconomic theory for the long run 12

1.5. Explaining nominal rigidities 18

1.6. Long-run versus short-run economic policies 23

1.7. Summary 24

1.8. Exercises 25

**Book one The Long Run  
Economic Growth, Long-run Unemployment  
and Structural Economic Policy 27**

**Part 1** Basic Theory and Empirics about Prosperity and Growth 29

**Chapter 2** Some facts about prosperity and growth 31

2.1. Measuring the wealth of a nation 34

2.2. The rich and the poor, the growing and the declining 36

2.3. Convergence 42

2.4. The long-run growth process 49

2.5. Summary 55

2.6. Exercises 56

**Chapter 3** Capital accumulation and growth: The basic Solow model 59

3.1. The basic Solow model 60

3.2. Analysing the basic Solow model 70

3.3. Steady state 76

3.4. Structural policy and the golden rule 80

3.5. Economic growth in the basic Solow model 83

3.6. Summary 87

3.7. Exercises 88

**Chapter 4** Wealth accumulation and capital mobility: The Solow model for a small open economy 96

4.1. The growing mobility of capital 96

4.2. A Solow model of a small open economy 102

4.3. Analysing the model: dynamics and steady state 106

4.4. Implications of an open capital account: advantages and drawbacks of globalization 111

4.5. Summary 119

4.6. Exercises 121

**Part 2** Exogenous Growth 127

**Chapter 5** Technological progress and growth: The general Solow model 129

5.1. The general Solow model 130

5.2. Analysing the general Solow model 132

5.3. Steady state in the general Solow model 138

5.4. Economic growth and convergence in the general Solow model 142

5.5. Growth accounting 147

5.6. Summary 152

5.7. Exercises 153

**Chapter 6** Education and growth: The Solow model with human capital 161

6.1. The Solow model with human capital 162

6.2. Steady state and comparative statics in the Solow model with human capital 167

6.3. Convergence in the Solow model with human capital 175

6.4. Discussing the Solow model with human capital and looking ahead 182

6.5. Summary 183

6.6. Exercises 185

**Chapter 7** Limits to growth? The Solow model with scarce natural resources 191

7.1. The Solow model with land 193

7.2. The Solow model with oil 200

7.3. The Solow model with both land and oil 204

**x** DETAILED TABLE OF CONTENTS

- 7.4. Unlimited substitution? An important issue of concern 208
- 7.5. Summary 210
- 7.6. Exercises 211

**Part 3** Endogenous Growth 217**Chapter 8** Productive externalities and endogenous growth 219

- 8.1. A growth model with productive externalities 220
- 8.2. Semi-endogenous growth 224
- 8.3. Endogenous growth 230
- 8.4. Exogenous versus endogenous growth 235
- 8.5. Summary 239
- 8.6. Exercises 241

**Chapter 9** R&D-based endogenous growth: Macroeconomic modelling 249

- 9.1. An R&D-based macro growth model 251
- 9.2. The law of motion 255
- 9.3. Semi-endogenous growth 257
- 9.4. Endogenous growth 262
- 9.5. 'Hemi-endogenous' growth 265
- 9.6. Summary 270
- 9.7. Exercises 272

**Chapter 10** R&D-based endogenous growth: Micro foundations 276

- 10.1. Ideas as economic goods 277
- 10.2. Romer's model of endogenous technological progress 284
- 10.3. Individual behaviour and aggregate equilibrium 290
- 10.4. Endogenous growth and the R&D share 296
- 10.5. Summary 303
- 10.6. Exercises 304

**Part 4** Structural Unemployment 311**Chapter 11** Some facts and introductory theory about unemployment 313

- 11.1. The social cost of unemployment 314
- 11.2. The rate of unemployment 315
- 11.3. Stylized facts about unemployment 320
- 11.4. Short-run cyclical and long-run structural unemployment 327
- 11.5. How large is frictional unemployment? 333
- 11.6. Summary 335
- 11.7. Exercises 336

**Chapter 12** Efficiency wages and unemployment 340

- 12.1. Efficiency wages: a basic example 340
- 12.2. A first look at the consequences of efficiency wages in a partial equilibrium framework 341
- 12.3. The causes of efficiency wages 346
- 12.4. Efficiency wages in a macroeconomic framework 351
- 12.5. Summary 360
- 12.6. Exercises 362

**Chapter 13** Trade unions and unemployment 368

- 13.1. Are unions important? 369
- 13.2. A partial equilibrium model of a unionized labour market 371
- 13.3. Trade unions in a macroeconomic framework 376
- 13.4. Summary 383
- 13.5. Exercises 384

**Appendix** Table A: Some growth relevant country data 390**Book two The Short Run****Economic Fluctuations, Short-run Unemployment and Stabilization Policy** 395**Chapter 14** The economy in the short run: Some facts about business cycles 397

- 14.1. Why understanding business cycles is important 397
- 14.2. Defining business cycles 400
- 14.3. Dating business cycles 401
- 14.4. Measuring business cycles 403
- 14.5. What happens during business cycles? 409
- 14.6. Measuring and decomposing the output gap: the production function approach 421
- 14.7. A look ahead 426
- 14.8. Summary 427
- 14.9. Exercises 428

**Part 5** The Building Blocks for the Short-run Model 431**Chapter 15** Investment and asset prices 433

- 15.1. The stock market 435
- 15.2. The price of stock 437
- 15.3. Business investment 441
- 15.4. The housing market and housing investment 450

- 15.5. Summary 456
- 15.6. Exercises 457

**Chapter 16** Consumption, income and wealth 465

- 16.1. The consumption function 466
- 16.2. The properties of the consumption function 477
- 16.3. Consumption, taxation and public debt 481
- 16.4. Towards a more realistic theory of consumption 486
- 16.5. Summary 489
- 16.6. Exercises 491

**Chapter 17** Monetary policy and aggregate demand 496

- 17.1. Keynes, the classics and the Great Depression 496
- 17.2. The goods market 498
- 17.3. The money market and monetary policy 502
- 17.4. The aggregate demand curve 513
- 17.5. Summary 516
- 17.6. Exercises 517

**Chapter 18** Inflation, unemployment and aggregate supply 520

- 18.1. Background: a brief history of the Phillips curve 520
- 18.2. Nominal rigidities, expectational errors and employment fluctuations 523
- 18.3. The expectations-augmented Phillips curve in a competitive labour market 533
- 18.4. Supply shocks 536
- 18.5. Testing the Phillips curve theory 538
- 18.6. The aggregate supply curve 542
- 18.7. Summary 545
- 18.8. Exercises 547

**Part 6** The Short-run Model for the Closed Economy 555

**Chapter 19** Explaining business cycles: Aggregate supply and aggregate demand in action 557

- 19.1. The model of aggregate supply and aggregate demand 559
- 19.2. Business fluctuations in a deterministic world 565
- 19.3. Business cycles in a stochastic world 571
- 19.4. A different perspective: real business cycle theory 581

- 19.5. Summary 590
- 19.6. Exercises 592

**Chapter 20** Stabilization policy: Why and how? 598

- 20.1. The goals of stabilization policy and the welfare costs of business cycles 599
- 20.2. Monetary stabilization policy 611
- 20.3. Fiscal stabilization policy 619
- 20.4. Summary 620
- 20.5. Appendix: calculating the asymptotic variance of output and inflation 622
- 20.6. Exercises 624

**Chapter 21** Stabilization policy with rational expectations 628

- 21.1. Backward-looking versus forward-looking expectations 629
- 21.2. Rational expectations and macroeconomic policy 633
- 21.3. Do people have rational expectations? 648
- 21.4. Summary 655
- 21.5. Exercises 657

**Chapter 22** The limits to stabilization policy: Credibility, uncertainty and time lags 662

- 22.1. Policy rules versus discretion: the credibility problem 662
- 22.2. Dealing with inflation bias: reputation-building and delegation of monetary policy 667
- 22.3. Groping in the dark: the implications of macroeconomic measurement errors 676
- 22.4. Time lags 681
- 22.5. Has fiscal policy been stabilizing? 685
- 22.6. Summary 689
- 22.7. Exercises 690

**Part 7** The Short-run Model for the Open Economy 695

**Chapter 23** Aggregate demand and aggregate supply in the open economy 697

- 23.1. The small specialized economy 698
- 23.2. Capital mobility, interest rate parity and purchasing power parity 700
- 23.3. Aggregate demand in the open economy 707
- 23.4. Aggregate supply in the open economy 712
- 23.5. Long-run equilibrium in the open economy 717

**xii** DETAILED TABLE OF CONTENTS

- 23.6. Summary 721  
23.7. Chapter Appendix: deriving the aggregate demand curve for the open economy 723  
23.8. Exercises 724
- Chapter 24** The open economy with fixed exchange rates 730  
24.1. Fixed exchange rates as an economic policy regime 730  
24.2. Macroeconomic adjustment under fixed exchange rates 735  
24.3. Fiscal policy 741  
24.4. Exchange rate policy 745  
24.5. Summary 758  
24.6. Exercises 761
- Chapter 25** The open economy with flexible exchange rates 766  
25.1. Flexible exchange rates as an economic policy regime 767  
25.2. Macroeconomic adjustment under flexible exchange rates 775  
25.3. A floating exchange rate: shock absorber or an amplifier of shocks? 780  
25.4. Summary 789  
25.5. Exercises 790
- Chapter 26** The choice of exchange rate regime and the theory of optimum currency areas 798  
26.1. Exchange rate regimes: past and present 798  
26.2. Fixed versus flexible exchange rates 805  
26.3. The theory of optimum currency areas 811  
26.4. Summary 818  
26.5. Exercises 819
- Appendix** Basic regression analysis 823  
1. Model and data 823  
2. OLS estimators 825  
3. The goodness of fit 827  
4. OLS estimators are BLUE 829  
5. Inference 832  
6. A final warning concerning causality 835
- Index** 837