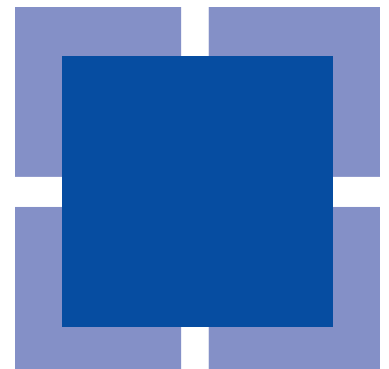


Foundations of
MACROECONOMICS

Robin Bade

Michael Parkin
University of Western Ontario



SEVENTH EDITION

Global Edition

PEARSON

Boston Columbus Indianapolis New York San Francisco Upper Saddle River
Amsterdam Cape Town Dubai London Madrid Milan Munich Paris Montréal Toronto
Delhi Mexico City São Paulo Sydney Hong Kong Seoul Singapore Taipei Tokyo

MACROECONOMICS

Brief Contents

PART 1	INTRODUCTION
	1 Getting Started, 39
	2 The U.S. and Global Economies, 69
	3 The Economic Problem, 95
	4 Demand and Supply, 119
PART 2	MONITORING THE MACROECONOMY
	5 GDP: A Measure of Total Production and Income, 151
	6 Jobs and Unemployment, 181
	7 The CPI and the Cost of Living, 203
PART 3	THE REAL ECONOMY
	8 Potential GDP and the Natural Unemployment Rate, 227
	9 Economic Growth, 251
	10 Finance, Saving, and Investment, 277
PART 4	THE MONEY ECONOMY
	11 The Monetary System, 303
	12 Money, Interest, and Inflation, 333
PART 5	ECONOMIC FLUCTUATIONS
	13 Aggregate Supply and Aggregate Demand, 361
	14 Aggregate Expenditure Multiplier, 387
	15 The Short-Run Policy Tradeoff, 413
PART 6	MACROECONOMIC POLICY
	16 Fiscal Policy, 435
	17 Monetary Policy, 461
	18 International Trade Policy, 489
	19 International Finance, 513
	Glossary G-1
	Index I-1
	Credits C-1

PART 1 INTRODUCTION

CHAPTER 1 Getting Started 39

CHAPTER CHECKLIST 39

- 1.1 Definition and Questions** 40
Scarcity, 40
Economics Defined, 40
What, How, and For Whom? 41
Can the Pursuit of Self-Interest Be in the Social Interest? 42

CHECKPOINT 1.1 45

- 1.2 The Economic Way of Thinking** 46
Economic Ideas, 46
A Choice Is a Tradeoff, 46
Cost: What You *Must* Give Up, 46
Benefit: What You Gain, 47
Rational Choice, 47
How Much? Choosing at the Margin, 48
Choices Respond to Incentives, 49
Economics as Social Science, 50
Economics as Policy Tool, 52

CHECKPOINT 1.2 54

CHAPTER SUMMARY 55

CHAPTER CHECKPOINT 56

Appendix: Making and Using Graphs 59

- Basic Idea 59
Interpreting Data Graphs, 60
Interpreting Graphs Used in Economic Models, 62
The Slope of a Relationship, 65
Relationships Among More Than Two Variables, 66

APPENDIX CHECKPOINT 68

EYE on the PAST

Adam Smith and the Birth of Economics as a Social Science, 51

EYE on the BENEFIT AND COST OF SCHOOL

Did You Make the Right Decision? 53

CHAPTER 2 The U.S. and Global Economies 69

CHAPTER CHECKLIST 69

- 2.1 What, How, and For Whom?** 70
What Do We Produce? 70
How Do We Produce? 72
For Whom Do We Produce? 75

CHECKPOINT 2.1 76

2.2 The Global Economy 77

- The People, 77
The Economies, 77
What in the Global Economy? 78
How in the Global Economy? 80
For Whom in the Global Economy? 80

CHECKPOINT 2.2 83

2.3 The Circular Flows 84

- Households and Firms, 84
Markets, 84
Real Flows and Money Flows, 84
Governments, 86
Governments in the Circular Flow, 87
Circular Flows in the Global Economy, 88

CHECKPOINT 2.3 90

CHAPTER SUMMARY 91

CHAPTER CHECKPOINT 92

EYE on the U.S. ECONOMY

What We Produce, 71

EYE on the PAST

Changes in What We Produce, 72

EYE on the U.S. ECONOMY

Changes in How We Produce in the Information Economy, 74

EYE on the Dreamliner

Who Makes the Dreamliner? 79

■ **EYE on the GLOBAL ECONOMY**

Differences in How We Produce, 81

■ **EYE on YOUR LIFE**

The U.S. and Global Economies in Your Life, 83

■ **EYE on the PAST**

Growing Government, 88

■ **EYE on the GLOBAL ECONOMY**

The Ups and Downs in International Trade, 90



CHAPTER 3
The Economic Problem 95

CHAPTER CHECKLIST 95

3.1 Production Possibilities 96

Production Possibilities Frontier, 96

CHECKPOINT 3.1 101

3.2 Opportunity Cost 102

The Opportunity Cost of a Cell Phone, 102

Opportunity Cost and the Slope
of the *PPF*, 103

Opportunity Cost Is a Ratio, 103

Increasing Opportunity Costs

Are Everywhere, 104

Your Increasing Opportunity Cost, 104

CHECKPOINT 3.2 105

3.3 Economic Growth 106

CHECKPOINT 3.3 108

3.4 Specialization and Trade 109

Absolute Advantage and Comparative
Advantage, 109

Comparative Advantage: An Example, 110

Achieving Gains from Trade, 112

CHECKPOINT 3.4 114

CHAPTER SUMMARY 115

CHAPTER CHECKPOINT 116

■ **EYE on YOUR LIFE**

Your Production Possibilities Frontier, 100

■ **EYE on the ENVIRONMENT**

Is Wind Power Free? 104

■ **EYE on the U.S. ECONOMY**

Expanding Our Production Possibilities, 107

■ **EYE on the GLOBAL ECONOMY**

Hong Kong's Rapid Economic Growth, 108

■ **EYE on the U.S. ECONOMY**

No One Knows How to Make a Pencil, 109

■ **EYE on YOUR LIFE**

Your Comparative Advantage, 112



CHAPTER 4
Demand and Supply 119

CHAPTER CHECKLIST 119

Competitive Markets 120

4.1 Demand 121

The Law of Demand, 121

Demand Schedule and Demand Curve, 121

Changes in Demand, 123

Illustrating Changes in Buying Plans, 124

CHECKPOINT 4.1 125

4.2 Supply 126

The Law of Supply, 126

Supply Schedule and Supply Curve, 126

Changes in Supply, 128

Illustrating a Change in Selling Plans, 129

CHECKPOINT 4.2 131

4.3 Market Equilibrium 132

Price: A Market's Automatic Regulator, 132

Predicting Price Changes: Three Questions, 133

Effects of Changes in Demand, 134

Effects of Changes in Supply, 136

Effects of Changes in Both Demand and Supply, 138

CHECKPOINT 4.3 140

4.4 Price Rigidities 141

Price Floor, 141

Price Ceiling or Price Cap, 143

Sticky Price, 145

CHECKPOINT 4.4 146

CHAPTER SUMMARY 147

CHAPTER CHECKPOINT 148

■ **EYE on YOUR LIFE**

Understanding and Using Demand and Supply, 130

■ **EYE on TUITION**

Why Does Tuition Keep Rising? 135

■ **EYE on the GLOBAL ECONOMY**

The Market for Solar Panels, 137

■ **EYE on the U.S. ECONOMY**

The Federal Minimum Wage, 143

PART 2 MONITORING THE MACROECONOMY

CHAPTER 5 GDP: A Measure of Total Production and Income 151

CHAPTER CHECKLIST 151

5.1 GDP, Income, and Expenditure 152

GDP Defined, 152

Circular Flows in the U.S. Economy, 153

Expenditure Equals Income, 154

CHECKPOINT 5.1 156

5.2 Measuring U.S. GDP 157

The Expenditure Approach, 157

The Income Approach, 159

GDP and Related Measures of Production
and Income, 161

Real GDP and Nominal GDP, 162

Calculating Real GDP, 162

Using the Real GDP Numbers, 163

CHECKPOINT 5.2 164

5.3 The Uses and Limitations of Real GDP 165

The Standard of Living Over Time, 165

Tracking the Course of the Business Cycle, 166

The Standard of Living Among Countries, 168

Goods and Services Omitted from GDP, 169

Other Influences on the Standard of Living, 170

CHECKPOINT 5.3 172

CHAPTER SUMMARY 173

CHAPTER CHECKPOINT 174

Appendix: Measuring Real GDP 177

The Problem With Base-Year Prices, 177

Value Production in the Prices of Adjacent
Years, 177

APPENDIX CHECKPOINT 180

■ EYE on the U.S. ECONOMY

Is a Computer Program an Intermediate Good or a
Final Good? 158

■ EYE on the BOOMS AND BUSTS

How Do We Track the Booms and Busts of our
Economy? 168

■ EYE on YOUR LIFE

Making GDP Personal, 170

■ EYE on the GLOBAL ECONOMY

Which Country Has the Highest Standard of
Living? 171

CHAPTER 6 Jobs and Unemployment 181

CHAPTER CHECKLIST 181

6.1 Labor Market Indicators 182

Current Population Survey, 182

Population Survey Criteria, 182

Two Main Labor Market Indicators, 183

Alternative Measures of Unemployment, 184

CHECKPOINT 6.1 186

6.2 Labor Market Trends and Fluctuations 187

Unemployment Rate, 187

The Participation Rate, 188

Alternative Measures of Unemployment, 190

A Closer Look at Part-Time Employment, 191

CHECKPOINT 6.2 192

6.3 Unemployment and Full Employment 193

Frictional Unemployment, 193

Structural Unemployment, 193

Cyclical Unemployment, 194

“Natural” Unemployment, 194

Unemployment and Real GDP, 195

CHECKPOINT 6.3 198

CHAPTER SUMMARY 199

CHAPTER CHECKPOINT 200

■ EYE on the U.S. ECONOMY

The Current Population Survey, 185

■ EYE on the GLOBAL ECONOMY

Unemployment Around the World, 188

■ EYE on the GLOBAL ECONOMY

Women in the Labor Force, 189

■ **EYE on the UNEMPLOYED**

How Long Does it Take to Find a Job? 194

■ **EYE on YOUR LIFE**

Your Labor Market Status and Activity, 196



CHAPTER 7

The CPI and the Cost of Living 203

CHAPTER CHECKLIST 203

7.1 The Consumer Price Index 204

Reading the CPI Numbers, 204

Constructing the CPI, 204

The CPI Market Basket, 204

The Monthly Price Survey, 205

Calculating the CPI, 206

Measuring Inflation and Deflation, 207

CHECKPOINT 7.1 209

7.2 The CPI and Other Price Level Measures 210

Sources of Bias in the CPI, 210

The Magnitude of the Bias, 211

Two Consequences of the CPI Bias, 212

Alternative Measures of the Price Level and Inflation

Rate, 213

CHECKPOINT 7.2 215

7.3 Nominal and Real Values 216

Dollars and Cents at Different Dates, 216

Nominal and Real Values in Macroeconomics, 217

Nominal GDP and Real GDP, 217

Nominal Wage Rate and Real Wage Rate, 218

Nominal Interest Rate and Real

Interest Rate, 220

CHECKPOINT 7.3 222

CHAPTER SUMMARY 223

CHAPTER CHECKPOINT 224

■ **EYE on the PAST**

700 Years of Inflation and Deflation, 208

■ **EYE on the U.S. ECONOMY**

Deflating the GDP Balloon, 217

■ **EYE on the PAST**

The Nominal and Real Wage Rates of

Presidents of the United States, 219

■ **EYE on BOX OFFICE HITS**

Which Movie *Really* Was the Biggest Box

Office Hit? 220

■ **EYE on YOUR LIFE**

A Student's CPI, 221

PART 3 THE REAL ECONOMY



CHAPTER 8

Potential GDP and the Natural Unemployment Rate 227

CHAPTER CHECKLIST 227

Macroeconomic Approaches and Pathways 228

The Three Main Schools of Thought, 228

Today's Consensus, 229

The Road Ahead, 230

8.1 Potential GDP 231

The Production Function, 232

The Labor Market, 233

CHECKPOINT 8.1 239

8.2 The Natural Unemployment Rate 240

Job Search, 241

Job Rationing, 242

CHECKPOINT 8.2 246

CHAPTER SUMMARY 247

CHAPTER CHECKPOINT 248

■ **EYE on the U.S. ECONOMY**

The Lucas Wedge and the Okun Gap, 230

■ **EYE on the GLOBAL ECONOMY**

Potential GDP in the United States and European

Union, 231

■ **EYE on U.S. POTENTIAL GDP**

Why Do Americans Earn More and Produce More Than

Europeans? 238

- **EYE on the PAST**
Average Unemployment Rates over Six Decades, 240
- **EYE on the GLOBAL ECONOMY**
Unemployment Benefits and the Natural Unemployment Rate, 242
- **EYE on the U.S. ECONOMY**
The Federal Minimum Wage, 245
- **EYE on YOUR LIFE**
Natural Unemployment, 245

CHAPTER 9 Economic Growth 251

CHAPTER CHECKLIST 251

- 9.1 The Basics of Economic Growth 252**
Calculating Growth Rates, 252
The Magic of Sustained Growth, 253
CHECKPOINT 9.1 255
- 9.2 Labor Productivity Growth 256**
Labor Productivity, 256
Saving and Investment in Physical Capital, 256
Expansion of Human Capital and Discovery of New Technologies, 258
Combined Influences Bring Labor Productivity Growth, 260
CHECKPOINT 9.2 263
- 9.3 Economic Growth Theories: Old and New 264**
Old Growth Theory, 264
New Growth Theory, 264
CHECKPOINT 9.3 267
- 9.4 Achieving Faster Growth 268**
Preconditions for Economic Growth, 268
Policies to Achieve Faster Growth, 269
How Much Difference Can Policy Make? 270
CHECKPOINT 9.4 272

CHAPTER SUMMARY 273

CHAPTER CHECKPOINT 274

- **EYE on the PAST**
How Fast Has Real GDP per Person Grown? 254

- **EYE on the U.S. ECONOMY**
U.S. Labor Productivity Growth Since 1960, 262
- **EYE on YOUR LIFE**
How You Influence and Are Influenced by Economic Growth, 266
- **EYE on RICH AND POOR NATIONS**
Why Are Some Nations Rich and Others Poor? 271

CHAPTER 10 Finance, Saving, and Investment 277

CHAPTER CHECKLIST 277

- 10.1 Financial Institutions and Markets 278**
Some Finance Definitions, 278
Markets for Financial Capital, 279
Financial Institutions, 281
Insolvency and Illiquidity, 282
Interest Rates and Asset Prices, 282
CHECKPOINT 10.1 283
- 10.2 The Loanable Funds Market 284**
Flows in the Loanable Funds Market, 284
The Demand for Loanable Funds, 284
The Supply of Loanable Funds, 287
Equilibrium in the Loanable Funds Market, 290
Changes in Demand and Supply, 291
CHECKPOINT 10.2 293
- 10.3 Government in Loanable Funds Market 294**
A Government Budget Surplus, 294
A Government Budget Deficit, 295
CHECKPOINT 10.3 298

CHAPTER SUMMARY 299

CHAPTER CHECKPOINT 300

- **EYE on the U.S. ECONOMY**
The Loanable Funds Market in a Financial Crisis, 292
- **EYE on YOUR LIFE**
Your Participation in the Loanable Funds Market, 296
- **EYE on FINANCIAL MARKETS**
Why Have Interest Rates Been So Low? 297

PART 4 THE MONEY ECONOMY

**CHAPTER 11**
The Monetary System 303**CHAPTER CHECKLIST** 303

- 11.1 What is Money?** 304
 Definition of Money, 304
 The Functions of Money, 304
 Money Today, 306
 Official Measures of Money: M1 and M2, 306
 Checks, Credit Cards, Debit Cards, and E-Checks, 307
 An Embryonic New Money: E-Cash, 308

CHECKPOINT 11.1 309

- 11.2 The Banking System** 310
 Commercial Banks, 310
 Thrift Institutions, 313
 Money Market Funds, 313

CHECKPOINT 11.2 314

- 11.3 The Federal Reserve System** 315
 The Structure of the Federal Reserve, 315
 The Fed's Policy Tools, 316
 How the Fed's Policy Tools Work, 317

CHECKPOINT 11.3 318

- 11.4 Regulating the Quantity of Money** 319
 Creating Deposits by Making Loans, 319
 How Open Market Operations Change the
 Monetary Base, 321
 The Multiplier Effect of an Open Market
 Operation, 324
 The Money Multiplier, 325

CHECKPOINT 11.4 328**CHAPTER SUMMARY** 329**CHAPTER CHECKPOINT** 330**EYE on the PAST**

The "Invention" of Banking, 311

EYE on the U.S. ECONOMYCommercial Banks Under Stress in the Financial
Crisis, 313**EYE on YOUR LIFE**

Money and Your Role in Its Creation, 319

EYE on CREATING MONEYHow Does the Fed Create Money and Regulate Its
Quantity? 326**CHAPTER 12**
**Money, Interest, and
Inflation 333****CHAPTER CHECKLIST** 333**Where We are and Where We're
Heading** 334

- The Real Economy, 334
 The Money Economy, 334
 Real and Money Interactions and Policy, 334

12.1 Money and the Interest Rate 335

- The Demand for Money, 335
 Changes in the Demand for Money, 337
 The Supply of Money, 338
 The Nominal Interest Rate, 338
 Changing the Interest Rate, 340

CHECKPOINT 12.1 342**12.2 Money, The Price Level, and Inflation** 343

- The Money Market in the Long Run, 343
 A Change in the Quantity of Money, 345
 The Price Level in a Baby-Sitting Club, 346
 The Quantity Theory of Money, 346
 Inflation and the Quantity Theory of Money 348
 Hyperinflation, 350

CHECKPOINT 12.2 352**12.3 The Cost of Inflation** 353

- Tax Costs, 353
 Shoe-Leather Costs, 354
 Confusion Costs, 354
 Uncertainty Costs, 355
 How Big Is the Cost of Inflation? 355

CHECKPOINT 12.3 356**CHAPTER SUMMARY** 357**CHAPTER CHECKPOINT** 358**EYE on the U.S. ECONOMY**

Credit Cards and Money, 340

EYE on YOUR LIFE

Money Holding and Fed Watching, 341

EYE on the PAST

Hyperinflation in Germany in the 1920s, 350

EYE on INFLATION

What Causes Inflation? 351

PART 5 ECONOMIC FLUCTUATIONS

CHAPTER 13 Aggregate Supply and Aggregate Demand 361

CHAPTER CHECKLIST 361

- 13.1 Aggregate Supply** 362
 Aggregate Supply Basics, 362
 Changes in Aggregate Supply, 365
CHECKPOINT 13.1 367
- 13.2 Aggregate Demand** 368
 Aggregate Demand Basics, 368
 Changes in Aggregate Demand, 370
 The Aggregate Demand Multiplier, 372
CHECKPOINT 13.2 373
- 13.3 Explaining Economic Trends and Fluctuations** 374
 Macroeconomic Equilibrium, 374
 Three Types of Macroeconomic Equilibrium, 375
 Economic Growth and Inflation Trends, 376
 The Business Cycle, 377
 Inflation Cycles, 378
 Deflation and the Great Depression, 380
CHECKPOINT 13.3 382

CHAPTER SUMMARY 383

CHAPTER CHECKPOINT 384

- **EYE on the U.S. ECONOMY**
 U.S. Economic Growth, Inflation, and the Business Cycle, 376
- **EYE on YOUR LIFE**
 Using the AS-AD Model, 380
- **EYE on the BUSINESS CYCLE**
 Why Did the U.S. Economy Go into Recession in 2008? 381

CHAPTER 14 Aggregate Expenditure Multiplier 387

CHAPTER CHECKLIST 387

- 14.1 Expenditure Plans and Real GDP** 388
 The Consumption Function, 388
 Imports and Real GDP, 392
CHECKPOINT 14.1 393

- 14.2 Equilibrium Expenditure** 394
 Induced Expenditure and Autonomous Expenditure, 394
 Aggregate Planned Expenditure and Real GDP, 394
 Equilibrium Expenditure, 396
 Convergence to Equilibrium, 397
CHECKPOINT 14.2 399
- 14.3 Expenditure Multipliers** 400
 The Basic Idea of the Multiplier, 400
 The Size of the Multiplier, 401
 The Multiplier and the MPC, 401
 The Multiplier, Imports, and Income Taxes, 402
 Business-Cycle Turning Points, 404
CHECKPOINT 14.3 405
- 14.4 The AD Curve and Equilibrium Expenditure** 406
 Deriving the AD Curve from Equilibrium Expenditure, 406
CHECKPOINT 14.4 408

CHAPTER SUMMARY 409

CHAPTER CHECKPOINT 410

- **EYE on the U.S. ECONOMY**
 The U.S. Consumption Function, 392
- **EYE on the PAST**
 Say's Law and Keynes' Principle of Effective Demand, 398
- **EYE on YOUR LIFE**
 Looking for Multipliers, 403
- **EYE on the MULTIPLIER**
 How Big Is the Government Expenditure Multiplier? 404

CHAPTER 15 The Short-Run Policy Tradeoff 413

CHAPTER CHECKLIST 413

- 15.1 The Short-Run Phillips Curve** 414
 Aggregate Supply and the Short-Run Phillips Curve, 415
 Aggregate Demand Fluctuations, 417
 Why Bother with the Phillips Curve? 418
CHECKPOINT 15.1 419

15.2 Short-Run and Long-Run Phillips Curves 420

- The Long-Run Phillips Curve, 420
- Expected Inflation, 421
- The Natural Rate Hypothesis, 422
- Changes in the Natural Unemployment Rate, 423
- Have Changes in the Natural Unemployment Rate Changed the Tradeoff? 424

CHECKPOINT 15.2 426

15.3 Influencing Inflation and unemployment 427

- Influencing the Expected Inflation Rate, 427
- Targeting the Unemployment Rate, 428

CHECKPOINT 15.3 430

CHAPTER SUMMARY 431

CHAPTER CHECKPOINT 432

■ EYE on the GLOBAL ECONOMY

Inflation and Unemployment, 417

■ EYE on the PAST

The U.S. Phillips Curve, 418

■ EYE on the PAST

A Live Test of the Natural Rate Hypothesis, 423

■ EYE on the TRADEOFF

Can We Have Low Unemployment *and* Low Inflation? 425

■ EYE on YOUR LIFE

The Short-Run Tradeoff in Your Life, 429

PART 6 MACROECONOMIC POLICY

CHAPTER 16 Fiscal Policy 435

CHAPTER CHECKLIST 435

16.1 The Federal Budget 436

- The Institutions and Laws, 436
- Budget Balance and Debt, 436
- The Federal Budget in Fiscal 2014, 437
- A Social Security and Medicare Time Bomb, 438

CHECKPOINT 16.1 440

16.2 Fiscal Stimulus 441

- Schools of Thought and Cracks in Today's Consensus, 441
- Fiscal Policy and Aggregate Demand, 442
- Automatic Fiscal Policy, 442
- Cyclical and Structural Budget Balances, 443
- Discretionary Fiscal Policy, 444
- A Successful Fiscal Stimulus, 445
- Limitations of Discretionary Fiscal Policy, 446

CHECKPOINT 16.2 447

16.3 The Supply Side: Potential GDP and Growth 448

- Full Employment and Potential GDP, 448
- Fiscal Policy, Employment, and Potential GDP, 448

Fiscal Policy and Potential GDP: A Graphical Analysis, 450

Taxes, Deficits, and Economic Growth, 451

The Supply-Side Debate, 452

Combined Demand-Side and Supply-Side Effects, 454

Long-Run Fiscal Policy Effects, 455

CHECKPOINT 16.3 456

CHAPTER SUMMARY 457

CHAPTER CHECKPOINT 458

■ EYE on the PAST

Federal Tax Revenues, Outlays, Deficits, and Debt, 439

■ EYE on the GLOBAL ECONOMY

The U.S. Budget in Global Perspective, 440

■ EYE on the U.S. ECONOMY

The U.S. Structural and Cyclical Budget Balances, 443

■ EYE on the GLOBAL ECONOMY

Some Real-World Tax Wedges, 449

■ EYE on FISCAL STIMULUS

Can Fiscal Stimulus End a Recession? 453

■ EYE on YOUR LIFE

Your Views on Fiscal Policy and How Fiscal Policy Affects You, 455

CHAPTER 17 Monetary Policy 461

CHAPTER CHECKLIST 461

17.1 How the Fed Conducts Monetary Policy 462

Monetary Policy Objectives, 462
Operational “Maximum Employment” Goal, 463
Operational “Stable Prices” Goal, 463
Responsibility for Monetary Policy, 464
Choosing a Policy Instrument, 464
The Federal Funds Rate, 464
The Fed’s Decision-Making Strategy, 465
Hitting the Federal Funds Rate Target, 467
Restoring Financial Stability in a Financial Crisis, 468

CHECKPOINT 17.1 469

17.2 Monetary Policy Transmission 470

Quick Overview, 470
Interest Rate Changes, 470
Exchange Rate Changes, 472
Money and Bank Loans, 472
The Long-Term Real Interest Rate, 473
Expenditure Plans, 473
The Fed Fights Recession, 474
The Fed Fights Inflation, 476
Loose Links and Long and Variable Lags, 478
A Final Reality Check, 478

CHECKPOINT 17.2 479

17.3 Alternative Monetary Policy Strategies 480

Why Rules? 480
Inflation Targeting Rule, 480
Money Targeting Rule, 481
Nominal GDP Targeting Rule, 483

CHECKPOINT 17.3 484

CHAPTER SUMMARY 485

CHAPTER CHECKPOINT 486

EYE on the U.S. ECONOMY

The Fed’s Interest Rate Decisions and the Taylor Rule, 466

EYE on the GLOBAL ECONOMY

Inflation Targeting Around the World, 481

EYE on the FED IN A CRISIS

Did the Fed Save Us From Another Great Depression? 482

EYE on YOUR LIFE

Your Views on Monetary Policy and How Monetary Policy Affects You, 483

CHAPTER 18 International Trade Policy 489

CHAPTER CHECKLIST 489

18.1 How Global Markets Work 490

International Trade Today, 490
What Drives International Trade?, 490
Why the United States Imports T-Shirts, 492
Why the United States Exports Airplanes, 493
Winners, Losers, and Net Gains From Trade, 494

CHECKPOINT 18.1 496

18.2 International Trade Restrictions 497

Tariffs, 497
Import Quotas, 500
Other Import Barriers, 501

CHECKPOINT 18.2 502

18.3 The Case Against Protection 503

Three Traditional Arguments for Protection, 503
Four Newer Arguments for Protection, 505
Why Is International Trade Restricted? 506

CHECKPOINT 18.3 508

CHAPTER SUMMARY 509

CHAPTER CHECKPOINT 510

EYE on the U.S. ECONOMY

U.S. Exports and Imports, 491

EYE on the GLOBALIZATION

Who Wins and Who Loses from Globalization? 495

EYE on the PAST

The History of U.S. Tariffs 497

EYE on YOUR LIFE

International Trade, 507

CHAPTER 19 International Finance 513

CHAPTER CHECKLIST 513

19.1 Financing International Trade 514

Balance of Payments Accounts, 514
Borrowers and Lenders, Debtors and Creditors, 516
Current Account Balance, 517
Net Exports, 517

CHECKPOINT 19.1 520

19.2 The Exchange Rate 521

- Demand in the Foreign Exchange Market, 522
- The Law of Demand for Foreign Exchange, 522
- Changes in the Demand for Dollars, 523
- Supply in the Foreign Exchange Market, 525
- The Law of Supply of Foreign Exchange, 525
- Changes in the Supply of Dollars, 526
- Market Equilibrium, 528
- Exchange Rate Expectations, 530
- Purchasing Power Parity, 530
- Monetary Policy and the Exchange Rate, 532
- Pegging the Exchange Rate, 532
- The People’s Bank of China in the Foreign Exchange Market, 533

CHECKPOINT 19.2 536

CHAPTER SUMMARY 537

CHAPTER CHECKPOINT 538

■ **EYE on the U.S. ECONOMY**

The U.S. Balance of Payments, 515

■ **EYE on the GLOBAL ECONOMY**

Current Account Balances Around the World, 519

■ **EYE on the DOLLAR**

Why Does Our Dollar Fluctuate? 529

■ **EYE on the GLOBAL ECONOMY**

Purchasing Power Parity, 531

■ **EYE on the GLOBAL ECONOMY**

The Managed Yuan, 535

■ **EYE on YOUR LIFE**

Your Foreign Exchange Transactions, 535

Glossary G-1

Index I-1

Credits C-1