Macroeconomics 9th edition Blanchard Solutions Manual

SKU: 9780138119119-SOLUTIONS

CHAPTER 1. A TOUR OF THE WORLD

The purpose of Chapter 1 is to give a sense of the questions which macroeconomics focuses on, from post-Covid inflation in advanced economies to growth in China.

I. MOTIVATING QUESTION

What is macroeconomics?

The chapter does not provide an explicit or formal answer. Instead, it takes you on an economic tour of the world and then describes the 2020 global Covid pandemic. Next the chapter reviews changes in the ratio of public debt to GDP for the United States, France, Germany and Japan. The chapter also provides an overview of the growth of China and its increasing importance in the world economy. The chapter concludes with discussions of growth and inequality, as well as the growing climate crisis. A working definition of macroeconomics at this point is the study of output, unemployment, and inflation, terms that will be defined precisely in Chapter 2.

II. WHY THE ANSWER MATTERS

This chapter attempts to provide students an incentive to master the theoretical material that follows in the remainder of the text. The implicit promise is that the theoretical model developed in the text will allow students to make sense of the various macroeconomic issues that continue to impact countries around the world.

III. KEY TOOLS, CONCEPTS, AND ASSUMPTIONS

1. Tools and Concepts

Chapter 1 does not provide any analytical tools. However, it does force students to confront some basic data and introduces data sources for various regions of the world. In addition, the chapter introduces and defines the concepts of **output**, **growth**, the **unemployment rate**, and the **inflation rate**. A more precise definition of these terms follows in Chapter 2.

Chapter 1 mentions in passing the terms **standard of living**, **productivity,** and **purchasing power parity**. All of these terms and concepts will be explored in later chapters in the text.

2. Assumptions

Implicit in the Tour of the World is the assumption that the same basic macroeconomic tools can be used to analyze economies throughout the world. It might be worth making this point explicitly. The macroeconomic framework developed in the text would be neither terribly useful, nor compelling as a theory, if it applied only to the United States, and not to the other market economies.

IV. SUMMARY OF THE MATERIAL

1. The Covid Crisis, Inflation, and Interest Rates

Included in the 9th edition of the textbook is a discussion of the effects of the Covid epidemic beginning in 2020. Figure 1-1 outlines the gross domestic product for the United States and the Euro Area, showing a large dip in the second quarter of 2020 due to the lockdowns imposed to stem the spread of the disease.

Figure 1-2 shows the evolution of inflation in the wake of the pandemic, as lockdowns were lifted and firms reopened. Government efforts to support people affected by the pandemic resulted in strong demand overheating both the labor and goods markets once restrictions were removed.

Figure 1-3 shows the monetary policy rates in the United States and the euro area, where policy rates were reduced to zero for a time in order to sustain demand. Central banks did not increase the interest rate to reduce inflation until 2022.

The economic crisis (as opposed to the health crisis) was triggered by the policy decisions to lock down countries. While this was justified on health grounds, it did mean that people could not go out to buy goods, and firms could not produce goods without workers, leading to a collapse in output.

During the pandemic, governments put in place programs to protect people who were no longer working and firms that were at risk of going bankrupt. The U.S. spent over $5 trillion on such programs.

The result was very strong demand once lockdowns ended. Unemployment decreased rapidly, putting pressure on wages. High demand for commodities led to large increases in the world prices of energy and food.

Many supply chains were still recovering as demand increased. Firms rationed demand via large price increases.

Central banks were slow to react. Policy rates remained at zero to stimulate demand; only in 2022 were interest rates increased in an effort to reduce inflation. Inflation has decreased since mid-2022, reflecting the improvement in supply chains and the stabilization of (and sometimes decrease in) commodity prices.

The question facing central banks is whether they have done enough to decrease overheating and return inflation to target. The risk of doing more is to slow down activity too much and trigger a strong recession. The risk of doing too little is to allow inflation to remain above target for a long time. The decline in housing prices and the collapse in stock prices lead to a decline in consumption of goods and services.

2. The Increase in Public Debt

This section discusses how fiscal deficits lead to increases in public debt.

Figure 1-4 shows the evolution of the debt ratio (the ratio of public debt to GDP) in four countries—the United States, France, Germany, and Japan—since 2001. Note that the debt ratios have two bumps, the first during the Global Financial Crisis of the late 2000s and the second during the early part of the Covid crisis.

During a crisis, government revenues go down more than does government spending, leading automatically to a larger deficit; in addition, the government may spend additional funds during the crisis. However these two crises explain only a small part of the increase in the debt ratios. Governments have used deficits, rather than trying to balance their budget through increases in taxes or decreases in spending.

Where should policymakers go next? Should governments work to reduce deficits and decrease high debt ratios via increasing taxes and/or cutting spending? Or is using debt to finance worthwhile objectives acceptable?

3. The Growth of China

China's economy commands the attention of macroeconomists because of its exceptional growth over the last few decades. China's GDP, which was equal to only 20% of US GDP in 1960, was roughly equal to that of the United States in 2019. China's growth rate has been much higher than that of the United States: 5.6% a year for China versus 3.0% for the United States, allowing China to fully catch up with the United States. Figure 1-5 shows the evolution of GDP in China and the United States since 1960.

Chinese citizens do not have the same standard of living as their US counterparts. China's population is much larger than that of the United States, so China's output per person is much less than the US equivalent. However, China's relative output per person has increased significantly in recent decades, as seen in Figure 1-6.

Why has China's growth been so high? First, large increases of physical capital enable workers to be more productive. Second, more and better education and training (human captial) allow workers to get better jobs and be more productive. Third, technological progress enables more output given physical and human capital.

Will all of these factors lead to continued high growth for China, or will changes such as the decline in population lead to lower growth? And can any of these experiences be applied to other countries?

4. Growth and Inequality

Inequality across countries has generally decreased, but inequality within countries, in particular within rich countries, has often increased. Figures 1-7 and 1-8 show three measures for the United States and France, respectively, and capture some of the dimensions of inequality.

While inequality is higher in the United States than in France, it is high in both countries. While inequality has increased in the United States, it has slightly decreased in France.

What is the relation between growth and inequality? Can growth in market economies benefit all, or does it naturally benefit some more than others? Does technological progress increase inequality? That depends. For example, artificial intelligence might take over some jobs, leaving workers unemployed, or it might assist workers to do more complex tasks and get better jobs.

5. Global Warming

There is overwhelming evidence that global warming is happening, and the consequences could be catastrophic. Figure 1-9 shows the rise in world temperature since 1880.

Is the fight technically winnable? Possibly, and governments do have policy tools that can be used to encourage and subsidize the research and development.

Is the goal of zero emissions consistent with positive growth? Yes, but the solution may result in lower growth for some time. Fighting global warming has a cost, but the alternative is worse.

Is there enough political will among the world's governments to combat climate change? It will be expensive, and voters may not accept increases in taxes, but an increase in debt may also be dangerous. Governments may be tempted to do little work and hope to benefit from the actions of others.

Should wealthier countries help poorer countries, which have not yet industrialized as much, bear the cost of fighting global warming? If they do not, can poorer countries, many of them already with large debt burdens, afford the cost?

V. PEDAGOGY

1. Alternative Sequencing

Output, the Unemployment Rate, and the Inflation Rate. Output, the unemployment rate, and the inflation rate are not defined precisely until Chapter 2. Some instructors may prefer to cover the definitions from Chapter 2, and possibly the discussion of why macroeconomists care about these variables, before discussing the material in this chapter.

2. Enlivening the Lecture

An alternative to posing the motivating question of this chapter is to ask students what they hope to learn from the course. The answers can be used to construct a description of what the course—and macroeconomics—is about. Another alternative is to begin a lecture on this chapter (and the course) by asking what the Federal Reserve should do with regard to interest rates. Students should develop alternative opinions based on illustrative newspaper quotes or student answers.

VI. EXTENSIONS

1. The Rest of the World

The Tour of the World presented in this chapter focuses attention on the United States, Europe, and China. Economic events in other regions are discussed only briefly at the end of the chapter. Current economic events in some of these regions are discussed at various places throughout the text. However, instructors may wish to devote more time to these regions at the outset, especially if the course will consider the open economy.

2. Positive and Normative Economics, Policy Disagreements, and Methodology

Instructors may wish to distinguish between positive and normative economics and to discuss how normative perspectives can lead economists to different policy prescriptions even when they agree on the facts. Instructors may also wish to remind students of the difficulties that economists and other social scientists face because of the inability to conduct controlled experiments.

3. Distribution of Economic Benefits

Income inequality is discussed in Chapter 13. Instructors may wish to raise this issue in the introductory discussion of the U.S. economy. It may be beneficial to point out that higher productivity growth is one way to address income inequality.

VII. APPENDICES

Appendix 1: Where to find the numbers

This appendix provides numerous sources of economic data on the Internet. Economic growth, inflation rates, unemployment rates and countless other macroeconomic and microeconomic data are available for almost every nation. Examples include FRED, OECD stat, and the World Economic Outlook Database.

Appendix 2: What do macroeconomists do?

Some of the students may wonder what they can do with a degree in economics. Those earning an undergraduate degree will probably work in the private sector helping the organization assess the economic situation. If you want a job at the IMF or World Bank you will probably have to get a Ph.D. The same holds true for jobs in higher education.