

# Preface

Bringing new textbooks in Introductory Economics to a market already supplied with a number of alternatives raises obvious questions. How are these new books distinct? What are the underlying motivations? What are the advantages for students and instructors?

Curtis, Irvine, Begg: *Microeconomics* and *Macroeconomics* are primarily new books and are not just Canadian adaptations of books focussed on other national economies. A fresh start has been made on the content, organization, and writing of most of the topics and issues covered.

However, we have built on the philosophy and pedagogy of David Begg's introductory book, *Economics*, which has dominated the United Kingdom market in recent years. His text is comprehensive for the needs of new students of economics, and focusses upon the essentials. We emphasize policy issues and the use of the core analytical tools that first year students should master. The results are books more focussed and more compact than virtually all books on the principles of economics in the Canadian marketplace. In contrast with some encyclopedic books, we make choices and concentrate on the core topics important to an introductory course.

Consistent with this approach, there are no appendices or "afterthought" chapters. If important material is challenging, it is still included in the main body of the text; it is not relegated elsewhere for a limited audience. The results are introductory *Microeconomics* and *Macroeconomics* books of just fifteen chapters and sixteen chapters respectively, four of which, three introductory and an international trade chapter, are common to both.

## NOTE ABOUT THE COVER:

*"If we look at the world in the form of a circle, let us look at what is on the inside of the circle as experience, culture and knowledge: let us look at this as the past ... What is outside of the circle is yet to be experienced. But in order to expand the circle we must know what is inside the circle ... it has been the art that has brought us back to our roots. ... I am proud to be one of those people chosen to put the puzzle back together and move on ... The challenge is ours to keep expanding the circle."*—Robert Davidson

## CONTENT

*Macroeconomics* provides complete, concise coverage of introductory macroeconomic theory and policy. It examines the Canadian economy as an economic system, and embeds current Canadian institutions and approaches to monetary policy and fiscal policy within that system. Particular attention is given to the recent structure, performance, and evolution of the Canadian economy, and to the current targets and instruments of Canadian monetary and fiscal policy.

The text also presents macroeconomics in the way students see it in the news media and in general discussion of the following topics:

- Business cycles in output, employment, prices, and financial markets are topics of ongoing reporting and discussion.
- Monetary and fiscal policy announcements get strong coverage, with discussions and opinion focussed on inflation targets, interest rate settings, budget balances, tax rates, expenditures, and public debt targets.
- Economic growth, productivity, and standards of living are important topics that arise regularly, mainly from international comparisons of economic performance.



The Aggregate Demand and Supply model is introduced early and used to help students understand these topics by tying them together within a consistent analytical framework. The analysis builds from a study of short-run business cycle fluctuations in output and employment, under constant price conditions, to longer-term issues of inflation and growth. A more detailed study of the balance of payments, exchange rate policy, and monetary and fiscal policy under different exchange rate systems completes the material.

The treatment of monetary and fiscal policy is modern and up-to-date:

- Canadian monetary policy is examined in terms of inflation targets, interest rate policy instruments, and current Bank of Canada operating techniques.
- Canadian fiscal policy is examined in terms of output stabilization, deficit and debt control targets, and the government's budget function.

Numerical examples, diagrams, and basic algebra are used in combination to illustrate and explain economic relationships. This approach gives students an important variety of ways to learn about the consumption function; aggregate expenditure; government budgets; the money supply; financial asset prices, yields, and interest rates; Okun's Law; the Philips curve; and other key relationships in the economy. Canadian and selected international data are used to provide real world examples and comparisons.

## STRUCTURE

The chapters in Macroeconomics are sequenced in a smooth, cumulative development of introductory macroeconomic theory and policy.

**PART 1, Chapter 1 (Economics and the Economy), Chapter 2 (The Tools of Economic Analysis), and Chapter 3 (Demand, Supply, and the Market)**, provides the conventional tool kit, covering the nature of economics, models, data and diagrams, and basic supply and demand.

**PART 2** provides an introduction to Canadian macroeconomics that differs in some ways from the usual approach.

**Chapter 4 (Measuring National Economic Activity and Performance)** uses a basic national accounts system to measure economic activity and performance in the usual way. Then the national accounts are used to provide a framework that links explicitly to the AD/AS model.

**Chapter 5 (Output, Business Cycles, and Employment)** bases the AD/AS model on the expenditure and income approaches in national accounts. It then uses AD/AS to illustrate nominal and real GDP, and to introduce business cycle analysis. Students see the main performance and policy issues, and the economic model, at the start of their study of introductory macroeconomics. Subsequent chapters elaborate on and analyze these issues.

**PART 3** starts the detail of model building on the real expenditure side of the economy. Aggregate demand is constructed in the conventional way, based on autonomous expenditures and multipliers. The material is developed using careful explanations of numerical examples, diagrams, and basic algebra. Up-to-date Canadian data are used to show the empirical dimensions of each expenditure component.

**Chapter 6 (Output, Aggregate Expenditure, and Aggregate Demand)** covers consumption, saving, and investment under constant prices to explain the position of the AD curve and the equilibrium level of real GDP when the AS curve is horizontal.

**Chapter 7 (Government and International Trade)** introduces the government sector, the government budget function, fiscal policy, and net exports.

In **PART 4**, to reflect the increased importance of financial markets and monetary policy in current work in macroeconomics, more emphasis is placed on the financial sector and monetary policy than is found in existing texts. This also corresponds to the interest many students show in financial markets and policy, and the attention these topics receive in the media.

**Chapter 8 (Money, Banking, and the Money Supply)** uses a basic, conventional approach to money, banking, and the money supply to establish the importance of monetary base, public cash holdings, and bank behaviour to the supply side of the money market.

The development of the demand for money balances in **Chapter 9 (Financial Markets, Interest Rates, and the Monetary Transmission Mechanism)** goes somewhat beyond the conventional approach. It is based on an introduction to financial asset prices and yields, and portfolio choices. However this approach is of particular importance to understanding the link between monetary policy and aggregate demand. Students find this material of particular interest and of current empirical relevance.

**Chapter 10 (Central Banking and Monetary Policy)** takes the modern approach to monetary policy. It uses simple monetary policy “rules” to explain current monetary policy. This approach is the key to understanding the Bank of Canada’s monetary policy, which is based on an inflation target and interest rate setting.

**PART 5** moves from a fixed price environment to one in which prices are flexible but sticky, and potential output is not fixed but can grow. This brings the discussion to the real world of inflation and growth that existing texts tend to avoid. It comes as a natural development of the preceding discussion of business cycles and stabilization policies, rather than as a supplementary topic.

**Chapter 11 (Monetary Policy and Fiscal Policy in the Short Run)** examines the short-run effects of fiscal and monetary policies and the recent evolution of Canadian macroeconomic policy.

**Chapter 12 (Aggregate Supply, Inflation, and Adjustments to Shocks)** introduces inflation in wages and prices to the short-run AS model, and gives the monetary policy an inflation target. Short-run output gaps cause changes in inflation rates to adjust the economy to potential output. The Bank of Canada’s current approach to monetary policy fits neatly within this framework.

**Chapter 13 (Economic Growth)** brings in growth in potential output and a brief examination of the sources and importance of productivity growth.

**PART 6** deals with international trade and finance.

**Chapter 14 (The Balance of Payments and Exchange Rates)** discusses the balance of payments and exchange rates. The approach to exchange rates makes explicit the link between the foreign exchange market and the flows of funds recorded in the balance of payments, a link many existing texts ignore.

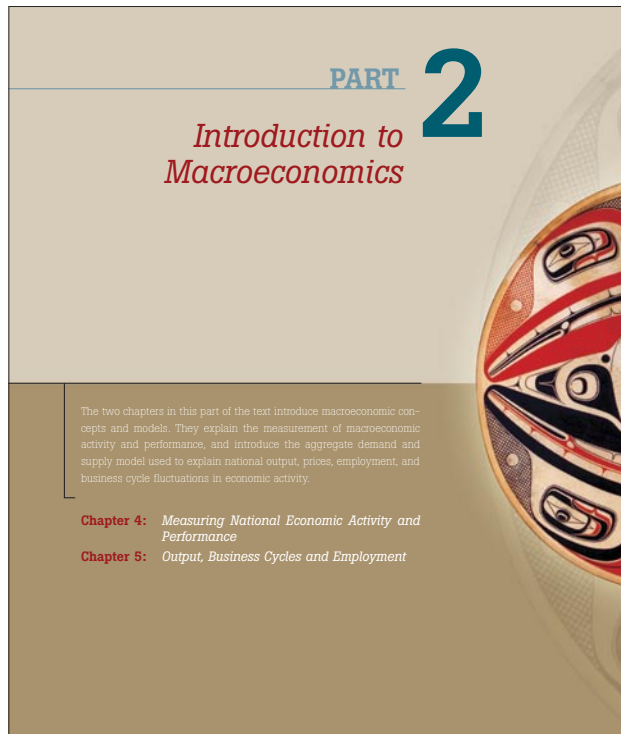
**Chapter 15 (International Trade)** examines the net export components of aggregate demand in more detail. It starts with the data on recent trading patterns and a discussion of the issues raised by international trade. The theory of comparative advantage is used to explain exports, imports, and the gains from international trade. Trade protectionism arising from tariffs, quotas, and subsidies is evaluated. The current institutions and multi-lateral agreements governing international trade are discussed.

**Chapter 16 (Open Economy Macroeconomics)** introduces open economy macroeconomics. The importance of the policy choice between fixed or flexible exchange rates for the effectiveness of monetary and fiscal policy is examined. Recent Canadian experience with flexible rates and inflation targeting are topics of particular interest.

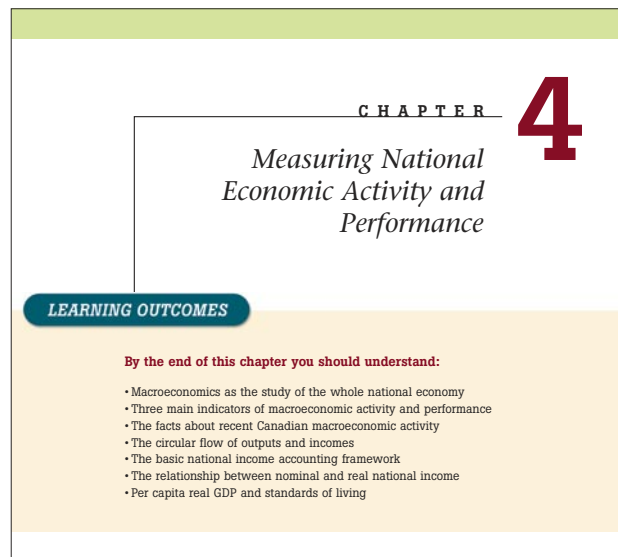
## LEARNING SOLUTIONS

To provide guidance and insights throughout the text, we include a number of proven pedagogical aids, including:

**Part Openers/Chapter Openers** set the scene for the areas of study in the chapters that follow.



**Learning Outcomes** identify the primary topics to be covered in the following pages, and highlight what should be understood when the chapter has been completed.



**Application Boxes** contain current and practical examples to highlight the application of the concepts to economics in the real world. These boxes also provide further and more in-depth discussions of key models and theories to expand on the core concepts in the book.



### APPLICATION BOX 8.2

#### Banks and Other Financial Services Institutions in Canada

The banks that accept and issue the deposits we use as money are a key part of the larger financial services industry in Canada. Trust companies, credit unions, caisses populaires, insurance companies, securities dealers, mutual fund companies, and independent financial advisors all play a role in this industry. But banks hold more than 70 percent of the assets in the financial services sector, and the six largest Canadian banks account for over 90 percent of the assets of the banking industry. Trust companies, credit unions, and caisses populaires also accept deposits that are used as money, but those deposits are a small fraction of the total of deposit money. As a result, bank deposits are the focus of our discussion of money in Canada. You will recognize the names of the big banks among the top ten

financial services companies in Canada listed in the table below.

The banks and other financial services companies provide important *financial intermediation* services to their customers: governments, businesses, and the general public. You will recall from Chapter 6 that equilibrium national income means that planned saving is equal to planned investment. In the more complex economy of Chapter 7, we saw that total planned leakages from the income stream will equal total planned injections into the stream. But planned leakages are the result of decisions that are different from the decisions that result in planned injections.

We need some mechanism to bring these two sets of decisions together. That is what financial intermediaries and financial markets do.

The Top 10 Financial Services Companies in Canada by Asset Size, 2003

Company	Total assets <sup>1</sup> (\$millions)
Royal Bank of Canada	403,185
Bank of Nova Scotia	285,892
Canadian Imperial Bank of Commerce	277,147
TD Financial Group	273,532
Bank of Montreal	256,494
Sun Life Financial Inc. <sup>2</sup>	163,295
Manulife Financial Corporation <sup>2</sup>	148,980
Great-West Lifeco Inc.	115,609
Mouvement des caisses Desjardins <sup>3</sup>	94,652
National Bank of Canada	82,493

**Summary Box**

The Algebra of Income Determination

We have used diagrams and numerical examples to show the determination of national income in an open economy based on autonomous expenditures and a multiplier. The following example shows the same thing, but in a general model.

Consumption	$C = C_0 + cYD$ , where $YD = Y - NT$
Investment	$I = I_0$
Government expenditure	$G = G_0$
Net taxes	$NT = tY$
Exports	$X = X_0$
Imports	$Z = zY$

The lower case letters  $c$ ,  $t$ , and  $z$  indicate induced relationships, and the subscript  $_0$  indicates initial values for autonomous expenditures.  
Aggregate expenditure is:

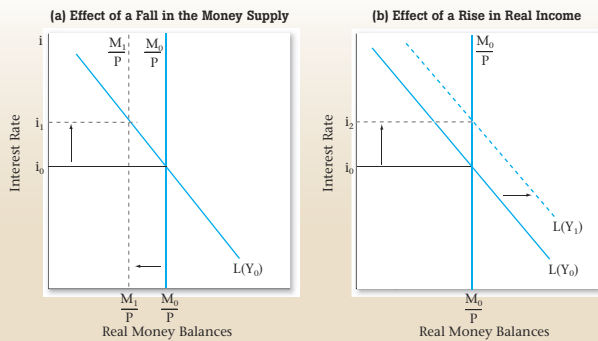
$$AE = C + I + G + NX, \text{ which, by substitution, is}$$

$$AE = C_0 + c(1 - t)Y + I_0 + G_0 + X_0 - zY, \text{ or}$$

$$AE = C_0 + I_0 + G_0 + X_0 + [c(1 - t) - z]Y$$

**Summary Box** appears where it is useful to emphasize and summarize key chapter content.

**FIGURE 9.4** Changes in Equilibrium Interest Rates



In panel (a), with given real income  $Y_0$ ,  $L$  is the demand for real money balances. A reduction in the real money supply from  $M_0/P$  to  $M_1/P$  moves the money supply function to the left. The excess demand for money at the initial interest rate  $i_0$  leads people to sell bonds to get money balances. Bond prices fall, raising bond yields and interest rates and reducing the quantity of real money balances demanded. Figure 9.1 (page 196) showed this relationship. Equilibrium is restored at the higher interest rate  $i_1$ .

In panel (b), with a given real money supply, an increase in real GDP shifts the demand for real money balances to the right from  $L(Y_0)$  to  $L(Y_1)$ . Interest rates rise to a new equilibrium at  $i_2$  as a result of bond sales that lower bond prices and raise yields. At  $i_2$ , the quantity of money balances demanded again equals the supply of balances.

**Figures and tables** are presented in a simple and clear design. The use of colour will help students to interpret and absorb key economic data and concepts. Captions explain what is being demonstrated.

**Review Question 4**

pose you have an emergency need for cab fare as a result of car trouble. Bonds can't be used to pay the fare, even if you had access to them and could sell them for cash. You need money. The precautionary motive for holding money balances is a reflection of these unexpected opportunities or needs.

If uncertainty is roughly constant over time, the volume of transactions and the benefits from holding precautionary balances depend on real GDP. The higher real income is, the stronger will be the precautionary motive for holding money. But a rise in uncertainty or anxiety, perhaps as a result of political events or economic forecasts, increases the demand for money as precautionary balances. Increased confidence lowers the demand for money balances.

**Review Questions** located at the end of each chapter encourage students to review and apply the knowledge acquired from each chapter. Text material tied into the Review Questions is indicated by a question-mark and the respective question numbers in the margin of the text.

**Next**

In this chapter we have looked at indicators of macroeconomic activity and performance, and the measurement of macroeconomic activity using the national accounts. We have not examined the conditions that determine the level of economic activity and fluctuations in that level. An economic model is required for that work. In the next chapter we start to build a simple macroeconomic model.

**"Next"** Feature appears before the end-of-chapter summary and is a paragraph linking the chapter in which it appears with the material to come in the next chapter.

**End-of-Chapter Summaries** review and reinforce the main topics covered in each chapter.

#### SUMMARY

- **Macroeconomics** studies the whole national economy as a system. It examines expenditure decisions by households, businesses, and governments, and the total flows of goods and services produced and incomes earned.
- **Real Gross Domestic Product (GDP)**, prices and **inflation rates**, and employment and **unemployment rates** are indicators of macroeconomic activity and performance.
- The **national accounts** provide a framework for the measurement of the output of the economy and the incomes earned in the economy.
- **Nominal GDP** measures the output of final goods and services at market prices in the economy, and the money incomes earned by the factors of production.
- **Real GDP** measures the output of final goods and services produced, and incomes earned at constant

**Key Terms** appear in boldface within the text where the term first appears, with the explanation provided in the margin and summarized at the end of each chapter.

#### KEY TERMS

Real GDP	61	Recession	66
Economic growth	61	Circular flow diagram	68
Rate of growth	62	Nominal GDP	69
Price level	62	Value added	70
Price index	62	Intermediate inputs	70
Consumer Price Index	62	Final goods and services	70
Inflation	62	Consumption expenditure (C)	70
Inflation rate	62	Investment (I)	71
Employment	62	Government expenditure (G)	71
Labour force	62	Exports (X)	71
Unemployment rate	63	Imports (Z)	71

**Key Equations and Relations** are serially numbered. Linear equations are explicitly solved in the textual development.

#### KEY EQUATIONS AND RELATIONS

##### Equations

$$\text{The price level } P = \frac{W}{Y} + \frac{BI + CCA}{Y} + \frac{T_{IN}}{Y} \quad (5.1) \quad \text{p. 90}$$

$$\text{The output gap} = \frac{Y - Y_p}{Y_p} \times 100\% \quad (5.2) \quad \text{p. 95}$$

$$\text{Unemployment rate: } u = \frac{\text{Labour force} - \text{number of people employed}}{\text{Labour force}} \times 100\% \quad (5.3) \quad \text{p. 97}$$

$$\text{Natural unemployment rate } u_n = \frac{\text{Labour force} - \text{equilibrium employment}}{\text{Labour force}} \times 100\% \quad (5.4) \quad \text{p. 97}$$

$$\text{Change in unemployment rate} = \Delta u = -\frac{1}{2}(\text{growth rate of } Y - \text{growth rate of } Y_p) \quad (5.5) \quad \text{p. 98}$$

##### Relations

**Aggregate demand AD:**  $\Delta P \rightarrow \Delta$  real financial wealth +  $\Delta$  domestic/foreign prices +  $\Delta$  interest rates  $\rightarrow \Delta$  expenditure and real output,  $(\Delta Y/\Delta P) < 0$

**Aggregate supply AS:**  $\Delta$  real output  $\rightarrow \Delta$  costs of production  $\rightarrow \Delta P$ ,  $(\Delta P/\Delta Y) > 0$

**Equilibrium real GDP and price:**  $AD = AS$

## COMPREHENSIVE LEARNING AND TEACHING PACKAGE

We have developed a number of supplements for both teaching and learning to accompany this text.

### Lyryx

**Lyryx Assessment for Economics** is a leading edge online assessment program designed to support both students and instructors. The assessment takes the form of a homework assignment called a Lab. The assessments are algorithmically generated and automatically graded so that students get instant grades and detailed feedback. New Labs are randomly generated each time, providing the student with unlimited opportunities to try a question. After they submit a Lab for marking, students receive extensive feedback on their work, thus enhancing their learning experience.



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The screenshot shows the 'MACRO ECONOMICS CANADIAN EDITION' website. The main content area is titled 'Macroeconomics' and lists authors: Doug Curtis (Trent University), Ian Irvine (Concordia University), and David Begg (University of London). It includes the ISBN 007098428X and a copyright year of 2007. A welcome message for the Online Learning Centre is present, along with a note for instructors regarding password protection. A sidebar on the left contains a navigation menu with items like Overview, Features, Table of Contents, Preface, Sample Chapter, Supplements, About the Authors, Page Out, Reviewers & Proposals, and Review Copies. The bottom of the page features a footer with copyright information for McGraw-Hill Higher Education and a link to the Terms of Use and Privacy Policy.

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- Instructor's Manual contains brief chapter outlines, introductions, examples, teaching tips, and answers to the end-of-chapter Review Questions.
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