MACROECONOMIC ANALYSIS
Second Edition

EDWARD SHAPIRO

A balanced coverage of the essentials of macroeconomic measurement, theory, and policy

HARCOURT, BRACE & WORLD

INTERNATIONAL EDITION
Containing the full and complete text of the regular edition

To the Memory of My Father

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FOREWORD TO THE FIRST EDITION

The power of macroeconomic analysis as a basis for public policy seems to become ever clearer with the passage of time. Today no student can hope to understand the major public issues or the instruments that are available to deal with them unless he has a thorough grounding in the theory of macroeconomics.

In this volume Professor Shapiro has provided a painstaking exposition that takes the student step by step through the relevant materials, making it easy for him to grasp and retain their logic. Through the use of two-, three-, and four-sector models, Professor Shapiro suggests clearly how the complexity of the real world is likely to affect the abstract concepts, and yet, in doing so, he never loses his reader. With his clear presentation of the accounting framework, his constant provision of supporting empirical data, and his gradual approach to a high level of sophistication, he has written a textbook that should prove invaluable to the student and should constitute an important contribution to education in economics.

WILLIAM J. BAUMOL

Princeton, New Jersey

PREFACE

The objective of this second edition, like that of the first, is to provide a treatment of macroeconomic measurement, theory, and policy designed specifically for the student who starts with only the limited grasp of economic analysis secured in the customary year of introductory survey work. As in the first edition, the treatment provided here does not call on the student to bridge the huge gap between introductory economics and graduate level macroeconomics in the one-semester course usually devoted to the subject. It does, however, attempt to provide him with a solid grasp of what are generally recognized as the fundamentals of macroeconomic analysis.

It is my opinion that a brief, outline type of treatment is of little value to the typical student at this level and that it is worth taking the space and effort needed to spell out the fundamentals clearly and understandably. The favorable reception given to the first edition of this book suggests that many teachers agree. Although a number of changes have been made for the second edition, the rule followed in the first edition is unchanged: Each topic is developed in sufficient detail to be meaningful to the student.

One obvious problem presented by this approach is the tendency for a text that follows it to grow to unmanageable proportions before all the topics that appear to be fundamental at the intermediate level have been covered. Of course, there is ample room for difference of opinion as to what is and what is not "fundamental." One such difference of opinion has led to the first of the major changes in the second edition. At the time I wrote the first edition, I felt that national income accounting was little less fundamental than national income theory, and I attempted to develop the former in almost as thorough a fashion as the latter. However, most teachers of the course apparently feel that a brief coverage of accounting is adequate. The result has been a compromise between these points of view. A large part of the material on national income accounting has been rewritten for the present edition, the number of pages devoted to the subject has been reduced substantially, and even the number of chapters devoted to the subject has been reduced by one. The shortened treatment, however, remains much more than an outline and, I hope, succeeds in presenting national income accounting in a way that the student can understand and not merely memorize.

ourse, they will surely agree today that any discussion of the relationship etween consumption and income requires analysis of the major income hyotheses. The chapter has therefore been reconstructed and expanded to include n equal treatment of the permanent income hypothesis, one that was unfortuately neglected in the first edition.

The section on the interaction of the multiplier and the acceleration rinciple, which was located in Chapter 14 in the first edition, has been relocated what is, apart from this section, a completely new chapter called "Business Cycle Theory." A discussion of the acceleration principle itself, which is clearly the area of investment, is provided, as it should be, in what is now Chapter 13 n investment demand, but the discussion of the interaction, which is just as learly in the area of cycle theory, has been shifted to where it belongs—Chapter 0 on business cycle theory. This essentially new chapter also provides analyses f Schumpeter's innovation theory in its relation to the cycle and of Kaldor's nodel of the cycle. Following the discussion of the multiplier-accelerator interction, the chapter examines Hicks's theory of the cycle, which is built on the nteraction.

Another change that deserves to be called major is in Chapter 23 on conomic growth theory. What was in the first edition essentially a presentation f the Domar model has now been expanded to provide an analysis of the differnce between the Harrod and Domar versions of what is commonly described s the Harrod-Domar model. Much more important, however, is the addition this chapter of a completely new part devoted to the neoclassical model, which has come to be a "must" in any coverage of growth theory. A fairly horough development of a simple neoclassical growth model is provided.

Dozens of other minor changes have been made throughout the book. ome are a matter of recognizing recent policy developments, such as the demise f the wage-price guideposts and the growing popularity of Friedman's monetary rule," while others have been made to recognize, although not always to ncorporate, important recent developments in theory, such as an interest-elastic upply function for money in place of the traditional assumption of a perfectly nelastic function.

I hope, of course, that all the changes made have been for the better. Responsibility for the final product rests solely with me, but it should be noted hat many of the changes, both major and minor, would not have been made xcept as a result of the numerous suggestions received from teachers over the ast three years. To each of them I wish to express my thanks. Especially valuble in this regard have been the detailed reviews provided by Professors oseph M. Perry of the University of Florida, Walter W. McMahon of the University of Illinois, Robert J. T. Emond of Denison University, and Bruce Gensemer of Kenyon College. My thanks also go to Professor William J. Baumol, who read the substantially revised and completely new sections of the nanuscript and provided many helpful suggestions.

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