6.8: The Macroeconomic Perspective

Learning Objectives

- Define macroeconomics
- Identify the major economic indicators used to assess the state of the macroeconomy

How is the Economy Doing? How Can We Know?

Figure 1. The Great Depression. At times, such as when many people are in need of government assistance, it is easy to tell how the economy is doing. This photograph shows people lined up during the Great Depression, waiting for relief checks. At other times, when some are doing well and others are not, it is more difficult to ascertain how the economy of a country is doing. (Credit: modification of work by the U.S. Library of Congress/Wikimedia Commons)

The 1990s were boom years for the U.S. economy. The late 2000s, from 2007 to 2013 were not. What causes the economy to expand or contract? Why do businesses fail when they are making all the right decisions? Why do workers lose their jobs when they are hardworking and productive? Are bad economic times a failure of the market system? Are they a failure of the government?

These are all questions of macroeconomics, which we will begin to address in this module. We will not be able to answer all of these questions here, but we will start with the basics: How is the economy doing? How can we tell?

The macro economy includes all buying and selling, all production and consumption; everything that goes on in every market in the economy. The quest to measure the macro economy began more than 80 years ago, during the Great Depression. President Franklin D. Roosevelt and his economic advisers knew things were bad—but how could they express and measure just how bad it was? An economist named Simon Kuznets, who later won the Nobel Prize for his work, came up with a way to track what the entire economy is producing. The result—gross domestic product (GDP)—remains our basic measure of macroeconomic activity. In this module, you will learn how GDP is constructed, how it is used, and why it is so important.

Macroeconomics

Macroeconomics focuses on the economy as a whole (or on whole economies as they interact). It describes what causes recessions, and what makes unemployment stay high when recessions are supposed to be over. Macroeconomics addresses why some countries grow faster than others, and have higher standards of living than others. Macroeconomics involves adding up the economic activity of all households and all businesses in all markets to get the overall demand and supply in the economy. However, when we do that, something curious happens. It is not unusual that what results at the macro level is different from the sum of the microeconomic parts. Indeed, what seems sensible from a microeconomic point of view can have unexpected or counterproductive results at the macroeconomic level. If this were not the case, we wouldn't need macroeconomics as a separate discipline and we could simply use microeconomics to study macroeconomic issues. We use the term **macroeconomic externality** to describe when what happens at the macro level is different from and inferior to what happens at the micro level.

Imagine that you are sitting at an event with a large audience, like a live concert or a basketball game. A few people decide that they want a better view, and so they stand up. However, when these people stand up, they block the view for other people, and the others need to stand up as well if they wish to see. Eventually, nearly everyone is standing up, and as a result, no one can see much better than before. The rational decision of some individuals at the micro level—to stand up for a better view—ended up being self-defeating at the macro level. This is not macroeconomics, but it is an apt analogy.

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The economy as a whole is massive. In order to determine how it is doing we use "economic indicators"— statistics that measure one or more aspects of the macro economic.

There is no one economic indicator that tells the whole story of the economy, so economists look at a variety of indicators some of which include:

- measures of aggregate production, like GDP
- measures of employment and unemployment, and measures of inflation, like the percent change in the Consumer Price Index
- the "Misery Index"—the sum of the inflation and unemployment rates as a measure of how bad (i.e., miserable) the economy is

The U.S. Department of Commerce even calculates the Index of Leading Economic Indicators, which is one attempt to combine multiple economic indicators to come up with one number that tries to predict the future path of the economy.

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Macroeconomic Goals, Framework, and Policies

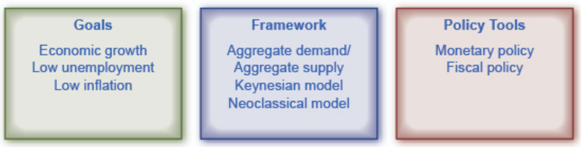

Figure 2. This chart shows what macroeconomics is about. The box on the left indicates a consensus of what are the most important goals for the macro economy, the middle box lists the frameworks economists use to analyze macroeconomic changes (such as inflation or recession), and the box on the right indicates the two tools the federal government uses to influence the macro economy.

Goals

In thinking about the overall health of the macroeconomy, it is useful to consider three primary goals: economic growth, full employment (or low unemployment), and stable prices (or low inflation).

- Economic growth ultimately determines the prevailing standard of living in a country. Economic growth is measured by the percentage change in real (inflation-adjusted) gross domestic product. Since the annual growth rate of the U.S. over the last hundred years averaged 3% per year, a growth rate above 3% is considered good.
- Unemployment, as measured by the unemployment rate, is the percentage of people in the labor force who do not have a job. When people lack jobs, the economy is wasting a precious resource-labor, and the result is lower goods and services produced. Unemployment, however, is more than a statistic—it represents people's livelihoods. While measured unemployment is unlikely to ever be zero, a measured unemployment rate of 5% or less is considered full employment.
- Inflation is a sustained increase in the overall level of prices. If many people face a situation where the prices that they pay for food, shelter, and healthcare are rising much faster than the wages they receive for their labor, there will be widespread unhappiness as their standard of living declines. For that reason, low inflation—an inflation rate of less than 5%—is a major goal.

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Frameworks

Economists use theories and models to explain and understand economic principles. In microeconomics, we used the theories of supply and demand; in macroeconomics, we use the theories of aggregate demand (AD) and aggregate supply (AS). This book presents two perspectives on macroeconomics: the Neoclassical perspective and the Keynesian perspective, each of which has its own version of AD and AS. Between the two perspectives, you will obtain a good understanding of what drives the macroeconomy.

Policy Tools

National governments have two sets of tools for influencing the macroeconomy. The first is monetary policy, which involves managing the interest rates and the availability of credit. The second is fiscal policy, which involves changes in government spending/purchases and taxes.

Each of the items in Figure 2 will be explained in detail in one or more other modules. As you learn these things, you will discover that the goals and the policy tools are in the news almost every day.

Learning Objectives

[glossary-page][glossary-term]macroeconomic externality: [/glossary-term][glossary-definition]occurs when what happens at the macro level is different from and inferior to what happens at the micro level; an example would be where upward sloping supply curves for firms become a flat aggregate supply curve, illustrating that the price level cannot fall to stimulate aggregate demand[/glossary-definition]
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