

Eighth Edition

MACROECONOMICS

Olivier Blanchard



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Library of Congress Cataloging-in-Publication Data

Name: Blanchard, Olivier (Olivier J.), author.

Title: Macroeconomics / Olivier Blanchard.

Description: Eighth Edition. | Hoboken : Pearson, [2021] | Revised edition of Macroeconomics, [2017]

Identifiers: LCCN 2019015670 | ISBN 9780134897899 | ISBN 0134897897

Subjects: LCSH: Macroeconomics.

Classification: LCC HB172.5 .B573 2019 | DDC 339—dc23 LC record available at <https://lccn.loc.gov/2019015670>

ScoutAutomatedPrintCode



ISBN 10: 0-13-489789-7
ISBN 13: 978-0-13-489789-9

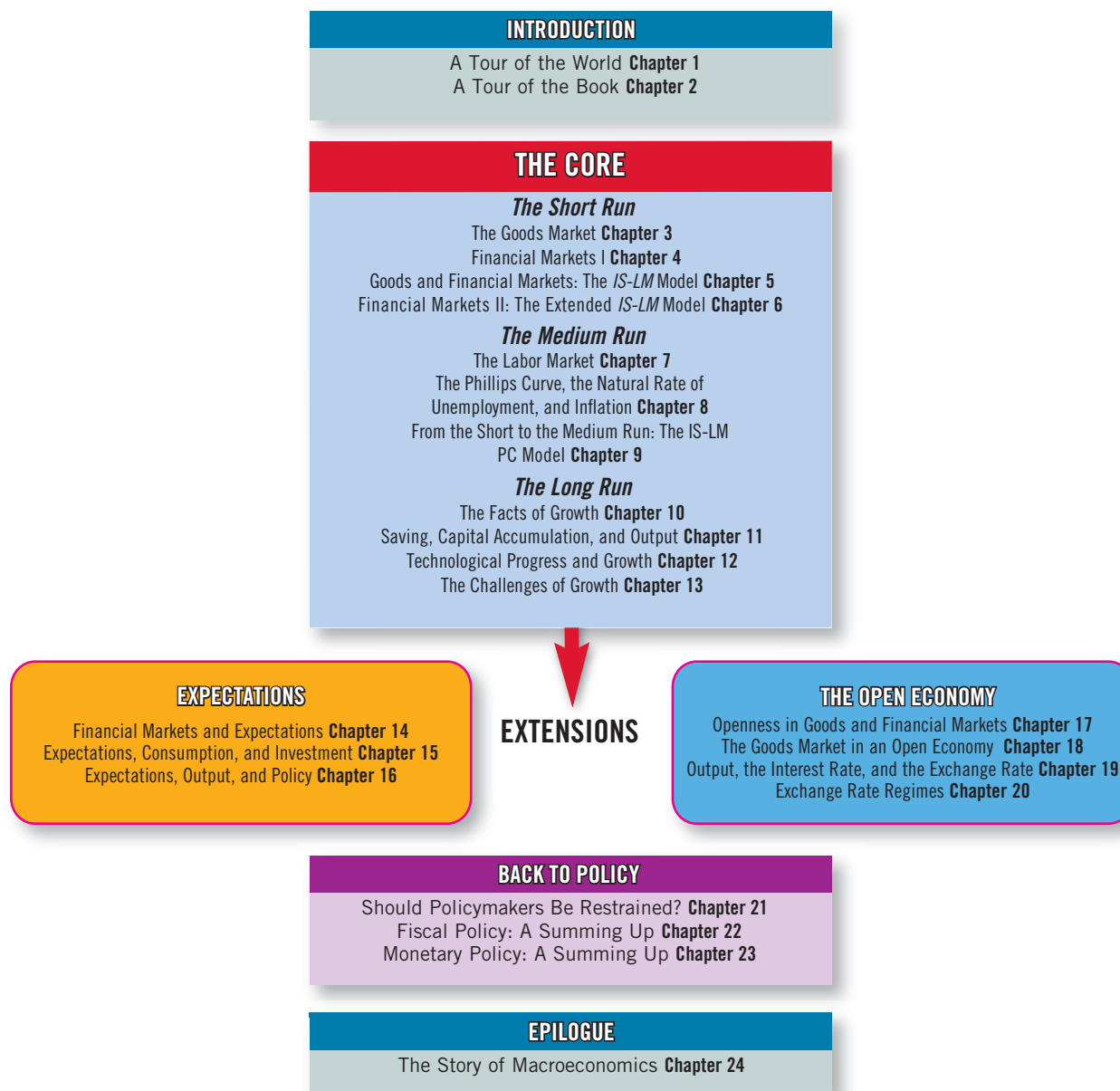
To Noelle



Flexible Organization

Macroeconomics, eighth edition is organized around two central parts: A core and a set of two major extensions. The text's **flexible organization** emphasizes an integrated view of macroeconomics, while enabling professors to focus on the theories, models, and applications that they deem central to their particular course.

The flowchart below quickly illustrates how the chapters are organized and fit within the book's overall structure. For a more detailed explanation of the **Flexible Organization**, and for an extensive list of **Alternative Course Outlines**, see pages **xiii–xiv** in the preface.



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Preface

I had two main goals in writing this book:

- To make close contact with current macroeconomic events. What makes macroeconomics exciting is the light it sheds on what is happening around the world, from the major economic crisis which engulfed the world in the late 2000s, to monetary policy in the United States, to the problems of the Euro area, to growth in China. These events—and many more—are described in the book, not in footnotes, but in the text or in detailed boxes. Each box shows how you can use what you have learned to get an understanding of these events. My belief is that these boxes not only convey the life of macroeconomics, but also reinforce the lessons from the models, making them more concrete and easier to grasp.
- To provide an integrated view of macroeconomics. The book is built on one underlying model, a model that draws the implications of equilibrium conditions in three sets of markets: the goods market, the financial markets, and the labor market. Depending on the issue at hand, the parts of the model relevant to the issue are developed in more detail while the other parts are simplified or lurk in the background. But the underlying model is always the same. This way, you will see macroeconomics as a coherent whole, not a collection of models. And you will be able to make sense not only of past macroeconomic events but also of those that unfold in the future.

Solving Learning and Teaching Challenges

Flexible Organization

The book is organized around two central parts: a core, and a set of two major extensions. An introduction precedes the core. The two extensions are followed by a review of the role of policy. The book ends with an epilogue. The flowchart at the beginning of this book makes it easy to see how the chapters are organized and fit within the book's overall structure.

- Chapters 1 and 2 introduce the **basic facts and issues of macroeconomics**. Chapter 1 takes you on an economic

tour of the world, from the United States, to the Euro area, and to China. Some instructors will prefer to cover Chapter 1 later, perhaps after Chapter 2, which introduces basic concepts, articulates the notions of short run, medium run, and long run, and gives the reader a quick tour of the book.

While Chapter 2 gives the basics of national income accounting, I have put a detailed treatment of national income accounts in Appendix 1 at the end of the book. This decreases the burden on the beginning reader and allows for a more thorough treatment in the appendix.

- Chapters 3 through 13 constitute the **core**.

Chapters 3 through 6 focus on the **short run**. Chapters 3 to 5 characterize equilibrium in the goods market and in the financial markets, and derive the basic model used to study short-run movements in output, the IS-LM model. Chapter 6 extends the basic IS-LM model to reflect the role of the financial system. It then uses it to describe what happened during the initial phase of the financial crisis.

Chapters 7 through 9 focus on the **medium run**. Chapter 7 focuses on equilibrium in the labor market and introduces the notion of the natural rate of unemployment. Chapter 8 derives and discusses the relation between unemployment and inflation, known as the Phillips curve. Chapter 9 develops the IS-LM-PC (PC for Phillips curve) model which takes into account equilibrium in the goods market, in the financial markets, and in the labor market. It shows how this model can be used to understand movements in activity and movements in inflation, both in the short and in the medium run.

Chapters 10 through 13 focus on the **long run**. Chapter 10 describes the facts, showing the evolution of output across countries and over long periods of time. Chapters 11 and 12 develop a model of growth and describe how capital accumulation and technological progress determine growth. Chapter 13, which is new, focuses on the challenges to growth, from inequality to climate change.

- Chapters 14 through 20 cover the two major **extensions**.

Chapters 14 through 16 focus on the role of expectations in the short run and in the medium run. Expectations play

a major role in most economic decisions and, by implication, play a major role in the determination of output.

Chapters 17 through 20 examine the implications of openness of modern economies. Chapter 20 looks at the implications of different exchange rate regimes, from flexible exchange rates, to fixed exchange rates, currency boards, and dollarization.

- Chapters 21 through 23 return to **macroeconomic policy**. Although most of the first 20 chapters constantly discuss macroeconomic policy in one form or another, the purpose of Chapters 21 through 23 is to tie the threads together. Chapter 21 looks at the role and the limits of macroeconomic policy in general. Chapters 22 and 23 review fiscal and monetary policy. Some instructors may want to use parts of these chapters earlier. For example, it is easy to move forward the discussion of the government budget constraint in Chapter 22 or the discussion of inflation targeting in Chapter 23.
- Chapter 24 serves as an **epilogue**; it puts macroeconomics in historical perspective by showing the evolution of macroeconomics over the last 80 years, discussing current directions of research, and the lessons of the crisis for macroeconomics.

Alternative Course Outlines

Within the book's broad organization, there is plenty of opportunity for alternative course organizations. I have made the chapters shorter than is standard in textbooks, and, in my experience, most chapters can be covered in an hour and a half. A few (Chapters 5 and 9 for example) might require two lectures to sink in.

- Short courses (15 lectures or less)

A short course can be organized around the two introductory chapters and the core (Chapter 13 can be excluded at no cost in continuity). Informal presentations of one or two of the extensions, based, for example, on Chapter 16 for expectations (which can be taught as a standalone) and on Chapter 17 for the open economy, can then follow, for a total of 14 lectures.

A short course might leave out the study of growth (the long run). In this case, the course can be organized around the introductory chapters and Chapters 3 through 9 in the core; this gives a total of 9 lectures, leaving enough time to cover, for example, Chapter 16 on expectations and Chapters 17 through 19 on the open economy, for a total of 13 lectures.

- Longer courses (20 to 25 lectures)

A full semester course gives more than enough time to cover the core, plus one or both of the two extensions, and the review of policy. The extensions assume knowledge of the core, but are otherwise mostly self-contained. Given the choice, the order in which they are best taught is probably the order in which they are presented in the book. Having studied the role of expectations first helps students to understand the interest parity condition and the nature of exchange rate crises.

Innovative Features

I have made sure never to present a theoretical result without relating it to the real world. In addition to discussions of facts in the text itself, I have written many Focus boxes, which discuss particular macroeconomic events or facts from the United States or from around the world. Many of those are new to this edition.

I have tried to re-create some of the student–teacher interactions that take place in the classroom by the use of margin notes, which run parallel to the text. The margin notes create a dialogue with the reader and, in so doing, smooth the more difficult passages and give a deeper understanding of the concepts and the results derived along the way.

For students who want to explore macroeconomics further, I have introduced the following two features:

- Short appendixes to some chapters, which expand on points made within the chapter.
- A 'Further Readings' section at the end of most chapters, indicating where to find more information, including key Internet addresses.

Each chapter starts with a one- or two-sentence summary at the end of the introduction, and ends with three ways of making sure that the material in the chapter has been digested:

- A summary of the chapter's main points.
- A list of key terms.
- A series of end-of-chapter exercises. "Quick Check" exercises are easy. "Dig Deeper" exercises are a bit harder, and "Explore Further" activities typically require either access to the Internet or use of a spreadsheet program.
- A list of symbols at the end of the book makes it easy to recall the meaning of the symbols used in the text.

What's New in This Edition

A new Chapter 13 on the challenges to growth. Topics include whether the introduction of robots will lead to mass unemployment, the relation between growth and inequality, and the challenges of climate change.

A revised Chapter 8 on the Phillips curve, reflecting a major change in the US economy. The Phillips curve is now a relation between inflation and unemployment rather than between the change in inflation and unemployment.

A revised Chapter 9 showing how the changes in the Phillips curve relation have led to changes in monetary policy.

A new appendix in Chapter 1, 'What Do Macroeconomists Do?', which will give you a sense of what careers you may pursue if you were to specialize in macroeconomics.

Updated Focus Boxes include:

- NEW! Will Bitcoins Replace Dollars? (Chapter 4)
- From Henry Ford to Jeff Bezos (Chapter 7)
- NEW! Nudging US Households to Save More (Chapter 11)
- What Lies Behind Chinese Growth? (Chapter 12)
- Uncertainty and Fluctuations (Chapter 16)
- NEW! US Trade Deficits and Trump Administration Trump Tariffs (Chapter 19)

Acknowledgments and Thanks

This book owes much to many. I thank Adam Ashcraft, Peter Berger, Peter Benczur, Efe Cakarel, Francesco Furno, Harry Gakidis, Ava Hong, David Hwang, Kevin Nazemi, David Reichsfeld, Jianlong Tan, Stacy Tevlin, Gaurav Tewari, Corissa Thompson, John Simon, and Jeromin Zettelmeyer for their research assistance over the years. I thank the generations of students in 14.02 at MIT who have freely shared their reactions to the book over the years.

I have benefited from comments from many colleagues and friends. Among them are John Abell, Daron Acemoglu, Tobias Adrian, Chuangxin An, Roland Benabou, Samuel Bentolila, and Juan Jimeno (who have adapted the book for a Spanish edition); Francois Blanchard, Roger Brinner, Ricardo Caballero, Wendy Carlin, Martina Copelman, Henry Chappell, Ludwig Chincarini, and Daniel Cohen (who has adapted the book for a French edition); Larry Christiano, Bud Collier, Andres Conesa, Peter Diamond, Martin Eichenbaum, Gary Fethke, David Findlay, Francesco Giavazzi, and Alessia Amighini (who adapted the book first for an Italian edition, and then for a European edition); Andrew Healy, Steinar Holden, and Gerhard Illing (who has adapted the book for

a German edition); Yannis Ioannides, Jose Isidoro Garcia de Paso Gomez, Per Krusell (who, with others, has adapted the book for a Swedish edition), Angelo Melino (who adapted the book for a Canadian edition), P. N. Junankar, Sam Keeley, Bernd Kuemmel, Paul Krugman, Antoine Magnier, Peter Montiel, Bill Nordhaus, Tom Michl, Dick Oppermann, Athanasios Orphanides, and Daniel Pirez Enri (who has adapted the book for a Latin American edition); Michael Plouffe, Zoran Popovic, Jim Poterba, and Jeff Sheen (who has adapted the book for an Australasian edition); Ronald Schettkat, and Watanabe Shinichi (who has adapted the book for a Japanese edition); Francesco Sisci, Brian Simboli, Changyong Rhee, Julio Rotemberg, Robert Solow, Andre Watteyne, and Michael Woodford. Thanks also go to David Johnson who wrote the end-of-chapter exercises for this edition.

I want to thank the reviewers that provided feedback for this new edition:

- Sahar Bahmani, University of Wisconsin Parkside
- Robert Blecker, American University
- LaTanya Brown-Robertson, Bowie State University
- Martina Copelman, University of Maryland, College Park
- Satyajit Ghosh, University of Scranton
- Ting Levy, Florida Atlantic University
- Sokchea Lim, John Carroll University
- Yu Peng Lin, University of Detroit-Mercy

I have also benefited from comments from many readers, reviewers, and class testers. Among them:

- John Abell, Randolph, Macon Woman's College
- Carol Adams, Cabrillo College
- Gilad Aharonovitz, School of Economic Sciences
- Terence Alexander, Iowa State University
- Roger Aliaga-Diaz, Drexel University
- Robert Archibald, College of William & Mary
- John Baffoe-Bonnie, La Salle University
- Fatolla Bagheri, University of North Dakota
- Stephen Baker, Capital University
- Erol Balkan, Hamilton College
- Jennifer Ball, Washburn University
- Richard Ballman, Augustana College
- King Banaian, St. Cloud State University
- Charles Bean, London School of Economics and Political Science
- Scott Benson, Idaho State University
- Gerald Bialka, University of North Florida
- Robert Blecker, American University

- Scott Bloom, North Dakota State University
- Pim Borren, University of Canterbury, New Zealand
- LaTanya Brown-Robertson, Bowie State University
- James Butkiewicz, University of Delaware
- Colleen Callahan, American University
- Bruce Carpenter, Mansfield University
- Kyongwook Choi, Ohio University College
- Michael Cook, William Jewell College
- Nicole Crain, Lafayette College
- Rosemary Cunningham, Agnes Scott College
- Evren Damar, Pacific Lutheran University
- Dale DeBoer, University of Colorado at Colorado Springs
- Adrian de Leon-Arias, Universidad de Guadalajara
- Brad DeLong, UC Berkeley
- Firat Demir, University of Oklahoma
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- Sharon J. Erenburg, Eastern Michigan University
- Antonina Espiritu, Hawaii Pacific University
- J. Peter Federer, Clark University
- Rendigs Fels, Vanderbilt University
- John Flanders, Central Methodist University
- Marc Fox, Brooklyn College
- Yee-Tien (Ted) Fu, Stanford University
- Yee-Tien Fu, National Cheng-Chi University, Taiwan
- Scott Fullwiler, Wartburg College
- Julie Gallaway, University of Missouri–Rolla
- Bodhi Ganguli, Rutgers, The State University of New Jersey
- Fabio Ghironi, Boston College
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- Fidel Gonzalez, Sam Houston State University
- Harvey Gram, Queens College, City University of New York
- Randy Grant, Linfield College
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- Thomas Havrilesky, Duke University
- George Heitmann, Muhlenberg College
- Ana Maria Herrera, Michigan State University
- Peter Hess, Davidson College
- Eric Hilt, Wellesley College
- John Holland, Monmouth College
- Mark Hopkins, Gettysburg College
- Takeo Hoshi, University of California, San Diego
- Ralph Husby, University of Illinois, Urbana–Champaign
- Yannis Ioannides, Tufts University
- Aaron Jackson, Bentley College
- Bonnie Johnson, California Lutheran University
- Louis Johnston, College of St. Benedict
- Barry Jones, SUNY Binghamton
- Fred Joutz, George Washington University
- Cem Karayalcin, Florida International University
- Okan Kavuncu, University of California
- Miles Kimball, University of Michigan
- Paul King, Denison University
- Michael Klein, Tufts University
- Mark Klinedinst, University of Southern Mississippi
- Shawn Knabb, Western Washington University
- Todd Knoop, Cornell College
- Paul Koch, Olivet Nazarene University
- Ng Beoy Kui, Nanyang Technical University, Singapore
- Leonard Lardaro, University of Rhode Island
- James Leady, University of Notre Dame
- Charles Leathers, University of Alabama
- Hsien-Feng Lee, National Taiwan University
- Jim Lee, Texas A&M University–Corpus Christi
- John Levendis, Loyola University New Orleans
- Frank Lichtenberg, Columbia University
- Mark Lieberman, Princeton University
- Shu Lin, Florida Atlantic University
- Maria Luengo-Prado, Northeastern University
- Mathias Lutz, University of Sussex
- Bernard Malamud, University of Nevada, Las Vegas
- Ken McCormick, University of Northern Iowa
- William McLean, Oklahoma State University
- B. Starr McMullen, Oregon State University

- Mikhail Melnik, Niagara University
- O. Mikhail, University of Central Florida
- Fabio Milani, University of California, Irvine
- Rose Milbourne, University of New South Wales
- Roger Morefield, University of Saint Thomas
- Shahriar Mostashari, Campbell University
- Eshragh Motahar, Union College
- Nick Noble, Miami University
- Ilan Noy, University of Hawaii
- John Olson, College of St. Benedict
- Brian O’Roark, Robert Morris University
- Jack Osman, San Francisco State University
- Emiliano Pagnotta, Northwestern University
- Biru Paksha Paul, SUNY Cortland
- Andrew Parkes, Mesa State College
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- Jim Peach, New Mexico State University
- Gavin Peebles, National University of Singapore
- Michael Quinn, Bentley College
- Charles Revier, Colorado State University
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- Kehar Sangha, Old Dominion University
- Ahmad Saranjam, Bridgewater State College
- Carol Scotese, Virginia Commonwealth University
- John Seater, North Carolina State University
- Peter Sephton, University of New Brunswick
- Ruth Shen, San Francisco State University
- Kwanho Shin, University of Kansas
- Tara Sinclair, The George Washington University
- Aaron Smallwood, University of Texas, Arlington
- David Sollars, Auburn University
- Liliana Stern, Auburn University
- Edward Stuart, Northeastern Illinois University
- Abdulhanid Sukaar, Cameron University
- Peter Summers, Texas Tech University
- Mark Thomas, University of Maryland Baltimore County
- Brian Trinque, The University of Texas at Austin
- Marie Truesdell, Marian College

- David Tufte, Southern Utah University
- Abdul Turay, Radford University
- Frederick Tyler, Fordham University
- Pinar Uysal, Boston College
- Evert Van Der Heide, Calvin College
- Kristin Van Gaasbeck, California State University, Sacramento
- Lee Van Scyoc, University of Wisconsin, Oshkosh
- Paul Wachtel, New York University Stern Business School
- Susheng Wang, Hong Kong University
- Donald Westerfield, Webster University
- Christopher Westley, Jacksonville State University
- David Wharton, Washington College
- Jonathan Willner, Oklahoma City University
- Mark Wohar, University of Nebraska, Omaha
- Steven Wood, University of California, Berkeley
- Michael Woodford, Princeton University
- Ip Wing Yu, University of Hong Kong
- Chi-Wa Yuen, Hong Kong University of Science and Technology
- Liping Zheng, Drake University
- Christian Zimmermann, University of Connecticut

They have helped me beyond the call of duty, and each has made a difference to the book.

I have many people to thank for this edition. Cameron Fletcher was a totally reliable proofreader and checker. At Pearson, I want to thank Chris DeJohn, content strategy manager; Samantha Lewis, product manager; Shweta Jain, content producer; Nayke Heine, product marketer; and Ashley Bryan, product and solutions specialist. At Integra, Denise Forlow, Gowthaman Sadhanandham and his team, for their work on the galleys.

Finally, I want to single out Steve Rigolosi, the editor for the first edition; and Michael Elia, the editor for the second and third editions. Steve forced me to clarify. Michael forced me to simplify. Together, they made all the difference to the process and to the book. I thank them deeply. I have also benefited from often-stimulating suggestions from my daughters, Serena, Giulia, and Marie: I did not, however, follow all of them. At home, I continue to thank Noelle for preserving my sanity.

Olivier Blanchard
Washington,
November 2019

About the Author



A citizen of France, **Olivier Blanchard** has spent most of his professional life in Cambridge, U.S.A. After obtaining his Ph.D. in economics at the Massachusetts Institute of Technology in 1977, he taught at Harvard University, returning to MIT in 1982. He was chair of the economics department from 1998 to 2003. In 2008, he took a leave of absence to be the Economic Counsellor and Director of the Research Department of the International Monetary Fund. Since October 2015, he has been the Fred Bergsten Senior Fellow at the Peterson Institute for International Economics, in Washington. He also remains Robert M. Solow Professor of Economics emeritus at MIT.

He has worked on a wide set of macroeconomic issues, from the role of monetary policy, to the nature of speculative bubbles, to the nature of the labor market and the determinants of unemployment, to transition in former communist countries, and to forces behind the recent global crisis. In the process, he has worked with numerous countries and international organizations. He is the author of many books and articles, including a graduate level textbook with Stanley Fischer.

He is a past editor of the *Quarterly Journal of Economics*, of the *NBER Macroeconomics Annual*, and founding editor of the *AEJ Macroeconomics*. He is a fellow and past council member of the *Econometric Society*, a past president of the *American Economic Association*, and a member of the *American Academy of Sciences*.