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CHAPTER 2. A TOUR OF THE BOOK

I. MOTIVATING QUESTIONS

1. How do economists define output, the unemployment rate, and the inflation rate, and why do economists care about these variables?

Output and the unemployment rate are defined in the usual fashion: output as the GDP and the unemployment rate as the percentage of the labor force not working. The text defines the inflation rate in two ways: the percentage change in the GDP deflator and the percentage change in the CPI. The link between output and the standard of living is implicit in the chapter. Economists care about the unemployment rate because the unemployed suffer, particularly if they remain unemployed for long periods of time, and because the unemployment rate provides an indicator of whether the economy is growing too fast or too slowly (concepts that will be defined precisely later in the book). Inflation has three main effects: it redistributes real income away from those who receive fixed nominal income, it distorts relative prices to the extent that some nominal variables do not adjust, and it creates uncertainty about relative price levels.

2. What factors affect output in the short run, the medium run, and long run?

This chapter introduces the basic framework of the book in terms of time. In the short run (a time frame of a few years), output is determined primarily by demand. In the medium run (a time frame of a decade or so), output is determined by the level of technology and the size of capital stock, both of which are never or less fixed. In the long run (a time frame of a half century or more), output is determined by technological progress and capital accumulation.

II. WHY THE ANSWERS MATTER

Students need a formal definition of the basic macroeconomic variables before they can analyze them. The discussion in this chapter provides enough information for students to begin looking at macroeconomic data. Moreover, some discussion of why economists care about these variables, particularly inflation, is useful to orient students.

III. KEY TOOLS, CONCEPTS, AND ASSUMPTIONS

1. Tools and Concepts

Chapter 2 introduces index numbers.