

FIFTH EDITION
PRINCIPLES OF

Macro-Monetary
ECONOMICS



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To the three beautiful girls in my life:

Jayashree, Lina, and Aditi

who insisted that they be named!



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Preface

It is a great pleasure to present this new edition; it reflects many substantial changes from the fourth edition of *Principles of Macro-monetary Theory*, which was published by Kendall/Hunt Publishing Company in 2003. The first edition of that book was published in 1986. Over the years we have sold numerous copies and have received many valuable comments from thousands of students who read those chapters. In the present fifth edition, while we have revised all chapters to infuse modern literature, ideas, theories, and updated data, we have also developed a very useful study guide that includes lists of important concepts, definitions, and practice problems. This book, therefore, includes the most simplified explanations of macroeconomic concepts and theories taught in any first macroeconomics class. In describing the theories, we have assumed that students have no prior background in economics, and that this is their first class in economic theory in general.

Hence, this edition begins with simple demand and supply arguments that govern the market mechanism, then builds on this subject with monetary developments such as money supply making in the United States and the gold standard system. The main macroeconomic theories are presented in a historical perspective starting with classical economics (Chapter 5) and Keynesian economics (Chapter 6). The functioning of institutions such as U.S. commercial banks (financial institutions) and the Federal Reserve System are discussed in Chapters 7 and 8, respectively. The essence of monetary theories of classical economics (à la old quantity theory of money) is presented in Chapter 9, while Keynesian arguments are summarized in Chapter 10. Even if a Keynesian bias is visible up through Chapter 10, the next chapter (Chapter 11) is completely "anti-Keynes" in terms of development of monetarism. Using the work of Friedman, we evaluate a number of problems with traditional Keynesian thinking.

In later chapters, we visit such important problems as inflation (Chapter 12), business cycles (Chapter 13), and the Phillips Curve Hypothesis (Chapter 14). Our analysis of the Phillips curve trade off brings in policy analysis with a major contribution from the Expectation Hypotheses summarized in Chapter 15. The last five chapters include somewhat modern developments in macro theory, including aggregate demand-aggregate supply framework (Chapter 16), a summary of new developments in macro monetary theory (Chapter 17), and macro theory in an open economy setting (Chapter 18). Open economy analysis needs some knowledge of the international monetary system, which is covered in Chapter 19. Chapter 20 integrates the theories with practice and evidence of U.S. economy. It shows that contemporary theories had a major impact on policy making and that learning economics is, in fact, a fruitful, applicable, and relevant venture.

I am quite sure that students will find the new edition quite interesting, stimulating, and rewarding. Instructors can select some chapters for higher emphasis, but in general a typical one-semester macro class would cover all of this information.

In completing this revision, I have incurred an enormous debt to numerous individuals. Mr. Stace Nicholson, one of my brightest graduate students, served as an invaluable research assistant. Without his many hours of hard work this revision could not have been finished on time. He was aptly supported by Ms. Sadie Cox and together they have made my work much easier. Several faculty colleagues have supported this venture, either by their presence around me or by many useful discussions that have led to refining my thoughts in presenting this material. I inadvertently may miss some names in the following list, but the prominent inspiring individuals are:

John P. Cochran, Dean, School of Business, Metropolitan State College of Denver

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Chaitram Talele, Columbia State College

Varkey Titus, Macon State University

The thousands of students I teach at different institutions have provided unlimited energy and zeal and inspired me to complete this book. I was absolutely amazed to run into one exceptional student (Mr. Christopher Dratz) who, after reading my entire textbook in less than three days, scored high enough points on the Test of Understanding College Economics (TUCE) to receive credit for the macro class! Students such as Chris and many others, make teaching a very worthwhile profession. I owe a huge debt of gratitude to the curious young minds who give me compliments by their words or through their actions by attending my classes.

Completing this book also meant spending several hours away from family obligations. The understanding of my family members—my wife Jayashree, and our daughters Dr. Lina Kulkarni, DDS, and Aditi Kulkarni—to whom I dedicate this edition, is very much appreciated. Editors and designers at Kendall/Hunt Publishing Company, Dubuque, Iowa, have been extremely cheerful and friendly. Ms. Ashley Blum and Ms. Karen Hoffmann spent hours working on this project, provided guidance, and finished the book in time for early adoption. Their invaluable support and friendly attitude definitely made the upgrades in this edition go very smoothly. I sincerely hope that readers like the exposition in this edition, and feel free to comment about its contents by sending an e-mail to my address: kulkarnk@mscd.edu.

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