

MACROECONOMICS, 3rd edition, O. J. Blanchard, 2005
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Review*

The standard textbook of Olivier Jean Blanchard is required reading for the undergraduate course at MIT and Harvard, as well as at other Ivy League and top world universities. Blanchard made his reputation in four important areas of macroeconomics: aggregate fluctuations of domestic product (the Blanchard-Quah decomposition of outputs); endogenous growth, economics of the labour market (particularly the analyses of the European labour market and *eurosclerosis*) and the area of the analysis of transition economies.

The book comprises 583 + xxiii pages of text, annexes (16 pages) and a glossary (10 pp.) and an index. It is divided into nine parts.

Introduction has an introduction to macroeconomic problems (*A Tour of the World*) and an introduction to the book (*A Tour of the Book*).

Short Term is the first of three parts (along with *Medium Term* and *Long Term*) that provide the hub of macroeconomic knowledge. In this part goods markets and financial markets are considered, and they are afterwards linked into a simultaneous equilibrium on the goods and financial markets, which is described with an IS-LM model.

Part three, *Medium Term*, provides a basic macroeconomic model of aggregate supply and demand (the AS-AD model), and explains the labour market, the natural rate of unemployment and inflation. As Blanchard really made his name in labour economics, the chapters about labour economics and the natural rate of unemployment are a great contribution to the standard level of macroeconomics textbooks. The second area in which Blanchard is celebrated is the decomposition of aggregate output, or GDP into the aggregate supply and the aggregate demand parts, and identification of shocks of aggregate demand and aggregate supply on aggregate economic fluctuations, which has greatly enhanced part of the standard account of the AD-AD model, and is once again a major contribution to macroeconomics as presented in textbooks. As brilliant analyst and economist Blanchard very simply presents methods for assessing macroeconomic equations

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connected to the AS and AD model, from the actual aggregate demand and aggregate supply to Okun's Law and the Phillips curve.

Part Four, *Long Term*, deals with the theories of economic growth, accumulation of capital and investment, technological progress and other problems of growth and development. A particularly important contribution is made by the last chapter of this part that links growth with wages and unemployment, showing the long-term dynamics of growth and unemployment, which is not a standard part of macroeconomic textbooks.

Expectations is the first of three parts (with *Open Economy* and *Pathologies*) that provide an expansion of the basic macroeconomic model shown in the first three parts. Here Blanchard introduces expectations and in a moderate and objective manner shows the whole revolution of rational expectations that has carried on, via the neo-classical and neo-Keynesian strand in the literature, the old divisions, adding to the classical and the Keynesian a new weapon and bringing about new workings of the old models. In the personal opinion of the present writer, this is the best explanation of the role of expectations with various macroeconomic variables in the many macroeconomic texts seen so far. Expectations are first of all brought in alongside investment and interest rates (inflationary expectations), and then the author brings them into the financial markets, afterwards revising the IS-LM model, adding the standard (real) IS-LM curves and expected IS-LM curves that might result from different equilibrium rates of interest and levels of output.

Open Economy gives a standard expansion of the basic macroeconomic model for the foreign sector. Here there is treatment of the exchange rate, balance of payments, foreign debt and international movements of capital. After bringing in the standard enlargement of the basic macroeconomic model for the foreign sector, Blanchard here too, via exchange rate expectations, introduces expectations from this side too into the macroeconomic model – also one of the simplest explanations of exchange rate expectations in macroeconomic texts.

Pathologies in two chapters gives a detailed insight into the biggest macroeconomic problems – depression (describing the Crash) and hyperinflation (describing historical major inflations like that in Germany between the wars). This is also a new approach in the material of a macroeconomic textbook, but it is an extremely useful one. For in extreme conditions it is easiest to understand the relations between (economic) variables – these are rare occasions when economists can, like other scientists, study a controlled experiment, that is, instead of small fluctuations among variables, where it is often difficult to discover, using statistical methods, significant correlations, in extremes like the Great Crash and hyperinflation, the trends of certain economic variables are so large that they have to reveal correlations with other variables.

The Return to (economic) Policy presents a more operational side of macroeconomics and a review of the main problems of the contemporary running of macroeconomic policies. First of all there is a discussion of economic policy theory and the ways in which it can best be managed, after which in the next two chapters there is a more detailed discussion of the two most important sets of economic policies – monetary and fiscal policy. Also given are the most recent discussions from the literature concerning the handling of economic policy, both monetary (the Taylor rules) and for fiscal policy (a balanced budget).

Epilogue works through the story of the development of the school of macroeconomic theory through history, and is one more new departure in this book of Blanchard.

The book is mainly meant for first degree level students and all who deal in a practical way with macroeconomics. Annexes to chapters contain more advanced topics, which makes the book suitable for postgraduate studies as well.

In the deluge of neo-classical macroeconomic texts like Barr's *Macroeconomics* (6th edition) that neglect mainstream economics and somewhat exaggeratedly stress rational expectations, the microeconomic bases of macroeconomics and the market, Blanchard's *Macroeconomics* contains a mainstream economics brought up to date with expectations. Thus this book gives a totally contemporary, objectively founded macroeconomic theory, without any bias towards the neo-classicists or the neo-Keynesians, whose debate is still going on in the professional literature; one day, the objectively treated and generally accepted conclusions of one school and the other will be shown in some new Blanchard publication. As well as contributions in the areas of explanations of aggregate fluctuations of domestic product, economic growth, economics of labour market and analysis of transition economics, this book in its substance and manner of exposition easily transmits and explains the most complex concepts regularly featured in his lectures to undergraduates and to postgraduate students at Harvard and MIT (as the present author personally witnessed in 1997/98), for which he has already several times been awarded prizes.

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