

Chapter 1

Macroeconomics and the “New” Economy: A Developed and Developing Country View

This chapter introduces macroeconomics and the “new” economy. What is macroeconomics? How is macroeconomic perspective different in developed and developing countries? How is it changed by the advent of the “new” economy? What is the relationship between stabilization over the business cycle and growth? What is the distinction between growth and development? How does the macroeconomy relate to business decision-making?

Introduction

At the beginning of the 21st century, we are confronted with a paradigm shift in economic growth, the “new” economy. In the 1970 to 1995 years, we had become accustomed to the contrast between the headlong rush to development in East Asia and the laggard growth and employment of the mature economies of the United States, Japan and Europe. In the mid-1990s, the rapid expansion or “economic miracle” in East Asia turned into a “meltdown.” The “tigers” became “sick cats.” Europe and Japan were finding it difficult to shake off their extended stagnation. The United States, on the other hand, was in a spectacular growth spurt — the “new economy.” Rapid technical change and globalization was spreading worldwide, to developed and developing countries alike. East Asia was again showing significant growth and there was hope that Europe and Japan would join the world economic recovery.

But conditions changed rapidly in 2000 and 2001. North America’s industrial growth was fading and there were quickly indications that the stock market “bubble” would burst. The European economies were showing signs of slowing expansion and Japan was again mired in its extended recession. Optimism about the vast potentials of information technology (IT) was

tempered by the realities of the business cycle. This record of economic change, which we consider in greater detail below, informs our introduction to macroeconomics.

We begin this chapter by describing the rapid fire changes that are sweeping across the world economy today. The term “the new economy” may mean different things to different observers. But certain ingredients are common to the new developments taking place in individual countries and in the relationships between them during the first decade of the new century.

This book looks at these developments from a macroeconomic perspective. In contrast to *microeconomics*, that is focused on the interaction of individual participants in the economy, *macroeconomics* views the economy as an aggregate. It is the study of the performance and operation of the economy as a whole: the nation’s gross domestic product (GDP), consumption, saving and investment, employment and unemployment, price level, interest rates, imports and exports, exchange rate, capital flows, etc. The aggregate statistics of economic performance reflect the fundamental changes taking place in the world economy.

Traditionally, macroeconomic analysis was a concern of developed mature economies dealing with problems of recession and inflation: stabilization over the business cycle. Increasingly, macroeconomics has been refocused toward longer term equilibrium, and particularly, the questions of growth and development that originally appeared to be of importance primarily to developing economies. In turn, the developing countries have recognized that they must place greater emphasis on macroeconomic stability, since it affects their ability to compete and to attract capital inflows. All countries are increasingly linked by the global economy. Today, we know that the concern about questions of domestic and international stability and of growth is common, though perhaps in somewhat different ways, to developed economies and to developing countries. Macroeconomics has been integrated into the theoretical and policy models of industrial and developing economies alike. Our presentation of macroeconomics for developed and developing countries recognizes that modern macroeconomics draws on the traditions of business cycle stabilization, growth and development economics, the

economics of technical change and information, and international trade and finance. We explain how these approaches are linked together, complementing rather than replacing one another.

Since macroeconomics deals with the economy as a whole, one might well ask how economic performance at the aggregate level is relevant to individual enterprises. Why is the study of macroeconomics a part of the business curriculum? As we outline in greater detail below, business enterprises operate in the setting of the economy. The market for products, supplies and the costs of raw materials and labor, interest rates and financing, and international competitiveness, all influence the performance of the business. Managers need not only react to current conditions, but to understand and, if possible, to forecast them. Business people must be “on top of” the economy, making forward-looking strategy in a precarious world. We conclude this chapter by showing the links between the macroeconomy and the business enterprise as a “cascade,” from the national economy to the industry and the firm.

Case 1.1

Distinguishing Between Developed and Developing Countries

How do we distinguish between developed and developing countries? We may use the terms: *rich* and *poor*, *advanced* and *backward*, *high income* and *low income*, *industrial* and *agricultural*, etc. The literature is full of euphemisms, particularly for the lower income countries, for example, *emerging economies*, *countries on the way to development*. The point is not so much in the name as in the meaning.

Countries range across a broad spectrum of economic development. Map 1.1 provides a geographic perspective. A detailed, statistical discussion of these differences is presented in Chapter 2.

At the upper end are the high income countries, with per capita incomes ranging in the \$10,000 to \$30,000 range (dark colored on the map). These are countries with extensive infrastructure, a largely urban population, an