Introduction to Economics

Agenda

• What is Macroeconomics?
• Why Do We Study Macroeconomics?
• How Do We Study Macroeconomics?

Economics

• Economics is the study of how people, both individually and collectively, choose to allocate, over time and space, scarce resources to the production and distribution of various goods and services.

Microeconomics

• Micro is Greek for small.
• Explains how markets work and the economic decisions made by individuals, households, business firms, industries, and units of government.
• Is partial equilibrium analysis.
• Provides a foundation for macroeconomics.

Macroeconomics

• Macro is Greek for large.
• Explains how and why the economy grows and fluctuates over time based on the decisions made, in the aggregate, by consumers, businesses, and governments.
• Is general equilibrium analysis.
• Explains variables taken as given in microeconomics.

Overview of the Course

• Definitions, Concepts, Key Relationships
• Long-run Economic Growth
  ➢ EXAM #1
• Short-run Business Fluctuations
  ➢ EXAM #2
• International Trade and Finance
• Medium-term Growth and Inflation
  ➢ EXAM #3
Overview of the Course

• The 3 major topics are related by the assumptions we make about how quickly wages and prices adjust in non-equilibrium situations.
  ➢ In the short-run, no adjustment.
  ➢ In the medium term, partial adjustment.
  ➢ In the long-run, full adjustment.

Why Study Macroeconomics?

• Macroeconomics is all around us.
  ➢ Provides the environment in which business firms operate.
  ➢ Provides the environment in which the political system operates.
  ➢ Is essential for the formulation and evaluation of good economic policy.
  ➢ Is endlessly fascinating because it provides a description of how the world operates.

How To Study Macroeconomics

• Macroeconomics is a model-based discipline.
  ➢ Therefore, we need to:
    ➢ Develop simple models that can generate useful and realistic explanations about the behavior of important macroeconomic variables.
    ➢ Apply these models to analyze historical and current macroeconomic developments and to make predictions about future events.

How To Study Macroeconomics

• Types of Economic Variables
  ➢ Exogenous: explained outside of the model.
  ➢ Endogenous: explained inside of the model.
  ➢ Constants and parameters: measures sensitivity of the relationship between variables.
How To Study Macroeconomics
• Economic models helps us tell stories about:
  ➢ How the key economic variables are related to one another.
  ➢ What happens to the endogenous variables if an exogenous variable(s) changes.
  ➢ What can be inferred about what happened to an exogenous variable(s) if an endogenous variable(s) changes.

How To Study Macroeconomics
• Types of descriptions:
  ➢ Verbal
  ➢ Graphical
  ➢ Mathematical

How To Study Macroeconomics
• Drawbacks of Economic Models
  ➢ Economics is not an exact science.
  ➢ The macroeconomy is highly complex and continues to evolve over time.
  ➢ General equilibrium analysis
  ➢ Economics is a behavioral science.
  ➢ Behavior can change over time.
  ➢ Relationships between variables can change.

How To Study Macroeconomics
• Using Economic Models
  ➢ Economic Theory
    ➢ A description of “what is”.
    ➢ Uses models to understand how the economy works.
    ➢ “Positive” economics.
  ➢ Economic Policy
    ➢ A description of “what should be”, a “value judgment.”
    ➢ Uses models to make policy recommendations.
    ➢ “Normative” economics.

Why Macroeconomist Disagree
• Theoretical Differences
  ➢ About the structure of the economy.
  ➢ About the sensitivity of the economy.
• Policy Differences
  ➢ About the appropriate role for government spending/taxing and monetary policy.
• Different Time Horizons
  ➢ Many disagreements revolve around different, but unspoken, time horizons.

Brief History of Macroeconomics
• Classical Macroeconomics
• The Great Depression
  ➢ John Maynard Keynes
• Long-Term Economic Growth
  ➢ Robert Solow
• Inflation
  ➢ A.W. Phillips, Edmund Phelps and Milton Friedman
• Unemployment
  ➢ Arthur Okun