Mankiw Macro Chapter I: Ten Principles of Economics

Introduction to the class….

Notes about self – Undergraduate, USAID, Graduate, Thailand

Personal Details, Biases

Contact information, availability, etc.

Notes on math and graphing

Class notes

Normal text – Lecture, taken from the book

Italics - Things I have added to the lecture

<u>Underlined – Skipped in lecture (but you must read)</u>

Blank spaces

I want you to do it with me (many graphs like this)

"Put down your pencil" means

PUT IT DOWN I WILL TELL YOU WHEN TO PICK IT UP

Occasionally I am editorializing (opinion, will not be on any test)

Usually, I want you to listen to what I am saying, **and get it**, not write it

Individual Decision-Making

Rationality: the "no-stupid" condition…..

What does a Hollywood movie look like?

What does a Thai Movie look like?

Why are we all here speaking English?

Economics from "oikonomos", Greek for "one who manages the household"

Who cooks, who does the dishes? Why?

Who cleans the clothes, who gets things off of high shelves? Why?

Like a household, "society" also makes decisions

Note "society" is the aggregate of individuals, and smaller societies

So work and resources go towards the production of goods,

Which are then distributed to the people and groups in society

THERE IS NEVER ENOUGH GOODS FOR ALL DESIRES

So trade-offs must be made. We can't all drive BMW's to school

Or do so at the same time

SCARCITY IS A CONSTANT, AND ALL DECISIONS REFLECT IT

If there is no scarcity, there is no economic decision to be made

So economics is the study of how individuals and society manages scarce resources

Principle 1. People face trade-offs (pg 4)

Their ain't no such thing as a free lunch *(TANSTAFL)*

<u>Students allocating their time</u>

<u>Parents allocating family income</u>

Thai Example: "Free Gifts"

There is also usually a trade-off between Efficiency and Equality

Efficient – getting the most one can from scarce resources

Equality – distributing goods equally among all people

Thai Example: "Free Health Care"

Everybody pays the same 30 baht to see a doctor
Whether you have a cold, or cancer
And they stay in the same line

Important point: the COST of something is not the same as the PRICE
Price is what we pay for it in the Market
Cost is the other things we give up to get it…..

Principle 2. The cost of something is what you give up to get it (pg 5)

Because we face trade-offs, we have to compare costs and benefits
Which we all do automatically, though often unconsciously
Consider the example of going to college. What are the costs and benefits?
Benefits: Better paying job in the future, intellectual enrichment
Costs: Tuition, Room and Board
Note, costs and benefits to whom?
Really, how about………

The opportunity cost of an item is what you have to give up to get it

Principle 3. Rational People think at the Margin (pg 6)

The Water-Diamond Paradox

Read Mankiw's examples

Pizza for dinner…..

Slices	Price	Benefit (of a slice)	Total Cost	Total Benefit	MC	MB
1	25	80	25	80		
2	25	60	50	140		
3	25	40	75	180		
4	25	20	100	200		
5	25	10	125	210		

Principle 4. People Respond to Incentives (pg 7)

Incentives: something that induces a person to act
Positive Incentives – rewards
Negative Incentives – punishments

Incentives matter – ALLWAYS
<u>Gas Prices, Bus driver pay</u>

EXTENDED EXAMPLE: The Peltzman Effect, Seatbelts, Airbags

How People Interact with each other…..

Principle 5. Trade can make everybody better off (pg 10)

LONG Digression on the moral case for free markets

I need a XXXXXX

VALUE IS SUBJECTIVE

Thus, two people can value the same thing differently
For reasons of taste, or for economic reasons
(Consider the pizza/beer example from earlier)

Trade improves individuals, it also improves nations

Principle 6. Markets are usually a good way to organize economic activity (pg10)

The collapse of communism
Centrally planned economies replace markets with politics/bureaucracies
E/W Germany, China/Taiwan, N/S Korea
Empirical FACT; central planning does not work in any "normal" sense
So the proper question is WHY markets work better, not IF they do

Markets are millions of individuals pursuing their own self-interest
They are NOT trying to promote the public good
Adam Smith: 1776, The Wealth of Nations

"Every individual necessarily labours to render the annual revenue of the society as great as he can. He generally neither intends to promote the public interest, nor knows how much he is promoting it ... He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for society that it was no part of his intention. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good." http://www.investopedia.com/terms/i/invisiblehand.asp#ixzz3iwZj0ZXV

By pursuing our own goals, we improve society

Because to be successful, we have to produce stuff that others value more than we do, and then exchange it for stuff we value more than they do.

We are rewarded for producing useful stuff, we reward others who produce useful stuff

And we do it without any guidance or instructions from somebody else.

How do we know something is valuable? Its price….

Govt. policies that distort prices, distorts (makes less efficient) the economy

Principle 7. Government can SOMETIMES improve Market outcomes

Market economies rely on the concept of property rights

You don't develop something

You can't sell something

You can't put something down,

Unless you own it, and society recognizes that.

The First role of Government is to define and protect property rights

Communism abolished private property, in favor of public property

But if everybody owns something, nobody does…

The second problem is MARKET FAILURE

Monopoly markets

Public Goods

Externalities

The third problem is questions of Equality and Equity

Markets don't guarantee a distribution of goods we approve of

Should professional tennis players earn more than surgeons?

IMPORTANT NOTE; THE EXISTENCE OF A MARKET FAILURE IS NOT SUFFICIENT EVIDENCE FOR THE CREATION OF A GOVERNMENT SOLUTION

Market failure must always be compared to Government Failure

Which is often (usually) worse

Ask your other professors about TQ 3

The Macro-Economy (pg 13)

Up to now, we have been talking about individuals, households, etc.

Sum of all the actors in the economy is the Macro-Economy

Micro is beautiful, Macro, not so much

Principle 8. Standard of living depends on the ability to produce stuff (pg 13)

Ultimately, you need to produce to have a good standard of living

To increase the standard of living, you must increase productivity

Per capital GDP U.S/Thailand, 55,000 vs. 5,000

55,000 vs. 15,000 (PPP)

55,000 vs. 37,000 (PPP U.S. to Bangkok)

Money isn't everything: but it is something…

Principle 9. Prices rise when the Government prints too much money (pg 15)

Most Inflation is caused by the Government

Principle 10. There is a short-run trade-off between inflation and unemployment (pg 16)

Skip for now…

Summary (Pg. 18) Table 1.

How people Make Decisions

1. **People face tradeoffs**
2. **The cost of something is what you give up to get it**
3. **Rational people think at the margin**
4. **People respond to incentives**

How People Interact

5. **Trade can make everyone better off**
6. **Markets are usually a good way to organize economic activity**
7. **Government can sometimes improve market decisions**

How the economy as a whole works

8. **A country's standard of living depends on its ability to produce**
9. **Prices rise when the government prints too much money**
10. **There is a short run tradeoff between inflation and unemployment**