

Econ 1: Final Review

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Administrivia: The March to the Final

- M Apr 30: Review
 - Finish Problem Set 9!
 - Seabright essay question...
 - Identifications...
- May 2: Office Hours 12-3
- May 4: Wheeler Auditorium 11-12
- M May 7: FINAL
 - 100 Haas Pavilion
 - 3-6 PM

Seabright Essay Question

- Paul Seabright argues that the market economy is built on top of two ancient human psychological predispositions—a predisposition to give each other reciprocal presents, and a predisposition to become very annoyed when the amounts of reciprocal presents between two people do not roughly balance out. What does Seabright say are the advantages of building our economy on these predispositions? What are the disadvantages? Where do you believe that Seabright’s argument is insightful, and why? Where do you believe that Seabright misses the point, and why?

Identifications

- Marginal rates of substitution
- Cobb-Douglas production functions
- Quotas
- Willingness to pay
- Marginal cost
- Marginal revenue
- John Stuart Mill
- John Maynard Keynes
- “Thick ties”
- “Grim” game-theoretic interaction strategies
- Perfect competition
- Total factor productivity
- Thomas Robert Malthus
- Circular flow of economic activity
- Expected inflation
- Interest rate spreads
- Collateralized Debt Obligations constructed from Mortgage-Backed Securities
- Excess demand for financial assets
- Consumer surplus
- Market equilibrium
- Total factor productivity
- Nominal interest rates
- Nominal GDP
- Real GDP
- Unemployment rate
- Employment-to-population ratio
- Labor-force participation rate
- Top 1%
- Education premium
- Monopolistic competition

Identifications

- Friedman's "three equalities"
- Cobb-Douglas utility functions
- Price ceilings as a way of regulating monopolies
- Price floors
- Long-run marginal cost
- Aggregate demand
- Government purchases
- The price level
- Inflation
- Investment expenditures by businesses
- The marginal propensity to consume
- Say' Law
- Partha Dasgupta
- Monopoly
- Monopolistic competition
- Hyman Minsky
- Thomas Robert Malthus
- Collateralized Debt Obligations constructed from Mortgage-Backed Securities
- Excess demand for financial assets
- Central planning
- Karl Marx
- Producer surplus
- Labor productivity
- Indifference curves
- Real interest rates
- Nominal GDP
- Real GDP
- Employment-to-population ratio
- Labor-force participation rate
- Top 1%
- College-high school wage premium

Auxiliary Readings

- Dasgupta
- Friedman and Friedman
- Seabright

Topics I

- What Economics Is
- Demand and Supply
- Market Equilibrium
- Market Elasticity
- Price Ceilings/Floors
- Governments Create Markets
- Governments Correct Markets
- Governments Override Markets

Topics II

- Consumers
- Businesses
- Perfect Competition
- Monopolistic Competition
- Monopoly
- Oligopoly and Strategy
- The Labor Market
- Economic Inequality

Topics III

- What Macroeconomics Is
- Aggregate Demand and the Income-Expenditure Framework
- Dealing with the Great Recession
- Origins of the Great Recession
- Inflation Economics
- Budget Economics
- Growth Economics

Calculations

- Supply and Demand
- Market Interventions
- Utility Theory
- Monopoly
- Monopolistic Competition
- National Income Accounting
- Income-Expenditure
- Phillips Curve
- Compound Growth

Lessons

- How did we get here?
- Market economy plus
- The direction of entrepreneurship
- Nuts and bolts of markets
- Market structure and dynamics
- The case for small-government utopia
 - The “night watchman” state
 - But over the past 30 years the world has not been kind to the central argument of *Free to Choose*
- Which gets us to where we are now: “it’s complicated”

Lessons: How Did We Get Here?

- We have had scientists, technologists, engineers, entrepreneurs, clever people, people watching their clever neighbors for a long time...
- We have had sustained technological advance for a long time...
- Yet somehow, here and now, we are all of a sudden—that is, within a couple of centuries—fabulously rich compared to our pre-industrial ancestors, or indeed compared to Desta
- We have this enormous planet-wide division of labor built on top of human gift-exchange social solidarity
- And we confidently expect our descendants and us 50 years from now to be 3 times as rich as we are
- How did this come about?

Lessons II: Market Economy Plus

- Market economy (as opposed to a centrally-planned economy): 80%
- But we have had other market economies that are not nearly as productive:
 - China from the Song to the Qing—or, indeed, to 1948
 - Classical Mediterranean Antiquity
- You also need the Rule of Law
- And you need a Culture of Engineering
- And you need Competent Economic Management

Lessons III: The Direction of Entrepreneurship

- Rule of Law:
 - "The history of enterprise in antiquity therefore falls naturally into two periods. First is the development of economic practices in Mesopotamia circa 3500-1200 BC. By the end of antiquity we find gain-seeking shifting away from productive enterprise to land acquisition, usury, profiteering from political office, and extraction of foreign tribute by force."
 - David S. Landes, Joel Mokyr, William J. Baumol, eds., *The Invention of Enterprise*
- A government that can preserve the Rule of Law against roving bandits, local notables, and its own functionaries is the most remarkable thing...

Lessons IV: Nuts and Bolts of Markets

- How does a market economy work?
 - Supply and demand
 - Market equilibrium
 - Consumer and producer surplus
 - Externalities and market failures
 - Market structure
 - Islands of central planning within the market economy
 - Perfect competition
 - In the long run, PC is a consumer surplus-generating machine
 - Monopoly
 - Tomorrow's monopoly profits are the spur to today's innovations
 - Intellectual property
 - Oligopoly
 - Monopolistic Competition

Lessons V: Market Structure and Dynamics

- Islands of central planning within the market economy
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Lessons VI: The Case for Small-Government Utopia

- Is the small-government utopia possible?
- Milton and Rose Director Friedman thought that it was:
 - If we get rid of formal, legal discrimination the market will produce an egalitarian distribution of income
 - Externalities are small and best dealt with through contract and tort
 - Or, at least, government failures are larger if you attempt to correct externalities through the state
 - Macroeconomic balance is easily achieved by a competent central bank

Lessons VII: The World Has Not Been Kind to *Free to Choose*

- The years since 1979 have not been kind to the argument of *Free to Choose*
 - Macro appears to be much more difficult—requires a much more activist intervening government and much more restrictive financial regulation
 - Is such regulation possible?
 - Where did our egalitarian distribution of income go?
 - What to do with externalities?

Lessons VIII: “It’s Kinda Complicated”

- A guide for the perplexed:
 - Recognize inconvenient facts
 - Mark your beliefs to market
 - Look at incentives
 - Look at tradeoffs
 - Look at systems
 - Look at long-term consequences

GOOD LUCK!!