Economics 2: Spring 2014

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http://delong.typepad.com/sdj/econ-2-spring-2014/

Economics 2: Spring 2014: Guiding Principles

http://delong.typepad.com/sdj/econ-1-spring-2012/

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A Set of Principles for Analyzing Market Economies

- Krugman and Wells:
  - Principles of individual decision-making
  - Principles of social interactions
  - Principles of macroeconomics
- I would add:
  - Where do markets come from?
  - What do markets get us?
  - What do we lose from markets?

Essentials of Economics I

- Principles of individual decision-making:
  - People must make choices because resources are scarce
    - What if resources aren't scarce? We'll focus our attention on an area of life in which they are scarce!
  - The opportunity cost of an item is its *true* cost
  - "How much" decisions inevitably involve making decisions *at the margin*
  - People *usually* respond to *material* incentives—exploiting opportunities to make themselves better off
    - "man has almost constant occasion for the help of his brethren, and it is in vain for him to expect it from their benevolence only"

Essentials of Economics II

- Principles of social interactions:
  - There are gains from trade
    - "In civilized society [man] stands at all times in need of the cooperation and assistance of great multitudes"
    - "[Man's] whole life is scarce sufficient to gain the friendship of a few persons"
    - "A spaniel endeavours by a thousand attractions to engage the attention of its master…. [Man] has not time, however, to do this upon every occasion"
  - Resources ought to be used as "efficiently" as possible
  - Markets move toward "equilibrium"
  - Market equilibrium usually (?) leads to efficiency
  - When markets don't achieve efficiency, government intervention can improve society's welfare

Essentials of Economics III

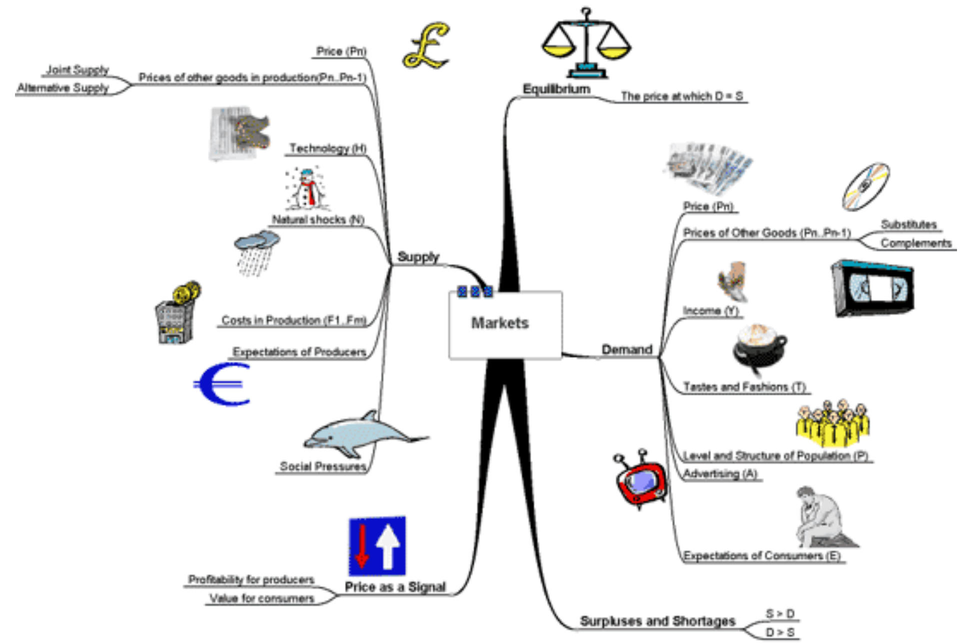
- Principles of macroeconomics:
  - One person's spending is another person's income
  - Overall spending sometimes gets out of line with the economy's productive capacity
  - Government policies can change spending
- But we won't talk about these until after spring break.
  - For the next two months we will assume that people in aggregate want to spend their incomes today
  - Those who want to spend less than their income are balanced by those who want to spend more

Governments Create Markets

- Money and trust
  - “Thick-tie” exchanges
  - “Thin-tie” exchanges
  - Weights and measures
- Property rights
- Contract enforcement
- Threats to property, contract, and (arms-length) exchange:
  - Positive and negative affective ties
  - Roving bandits
  - Local notables
  - Government’s own functionaries

What the Market System Gets Us

- People can "specialize" in what they are most productive doing
- People can become more productive
- People can trade via this institution called "market"
- Market exchange is win-win
  - Relative to baseline
- Market exchange maximizes wealth
  - As long as commodities are excludible, rival, known, and internal
- Distribution?



SLIDE DECK BREAK