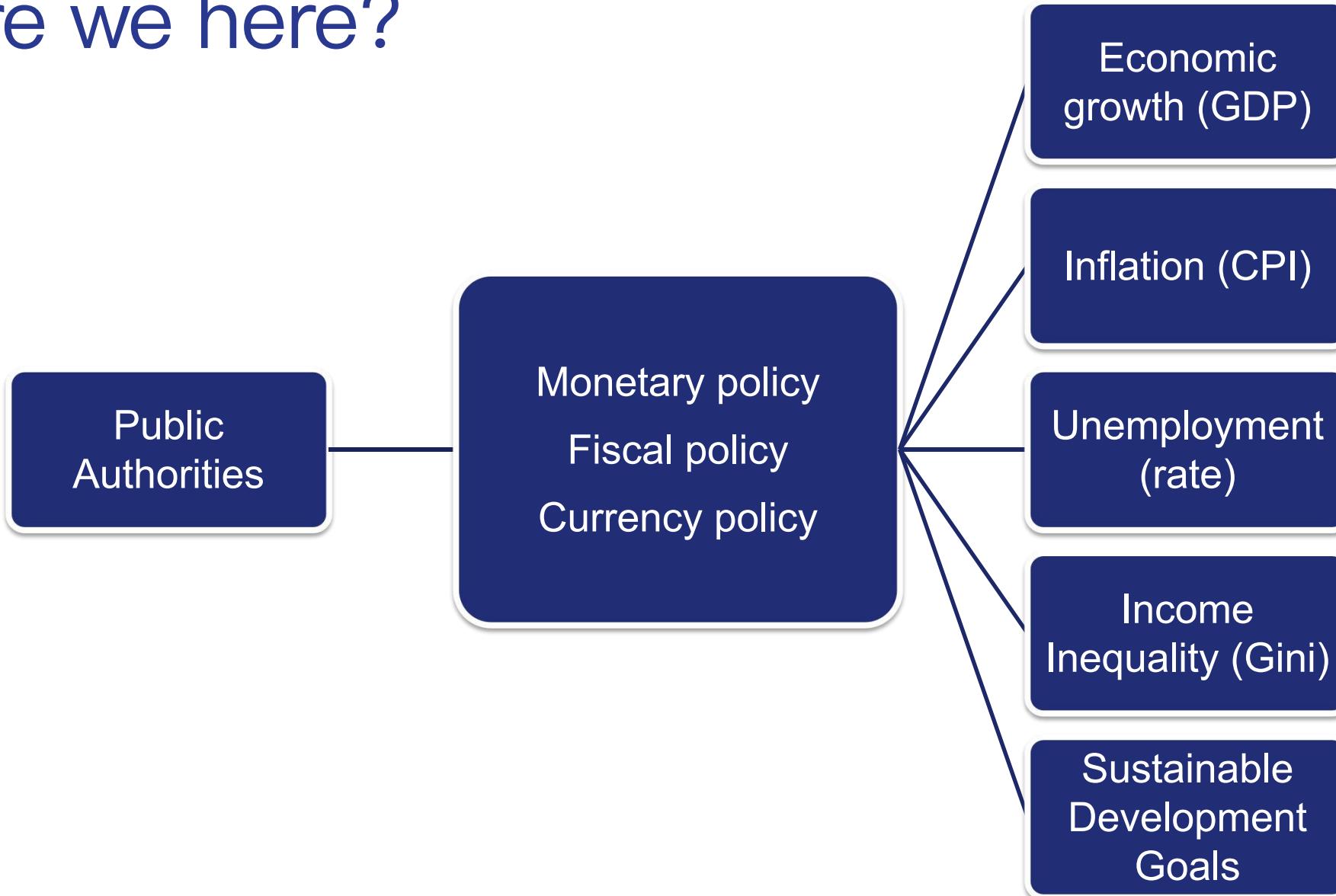


The basics

Chapter 1

Why are we here?



Role of Governments

Governments

- ❑ provide public goods and correct market failures;
- ❑ pursue macroeconomic stability;
- ❑ determine how much and through which means income should be redistributed.

Structure of the book

Markets
goods and
services
money;
loanable
funds; lab
currency

Long and
short run
dynamics;
Growth
gaps,
sustained
growth,
stagflation.

Monetary
and fiscal
policies,
interactions
and
restrictions

From closed
to open
economy;
balance of
payments
and
exchange-
rate regimes

Currency
policy;
trilemma;
interaction
between
economic
policies.

GDP;
inflation;
unemploy
ment;
inequality
and
sustainabilit
y

Integratio
between
markets

Assumptions and Equilibria

- ❑ Economic models work on assumptions and are supposed to be ideologically neutral.
- ❑ They should describe the real world and allow for reliable conditional forecasts.
- ❑ Building models based on simplified assumptions is at the core of science.
- ❑ This book favors comparative statics over full-blown dynamic models (more on this on chapter 2).

Shocks and Perturbations

- ❑ Examples of shocks: financial crises, the effect of a trade war initiated by country A on country B, the unexpected discovery of huge oil reserves, a sudden spike in interest rates worldwide, an inflow of foreign investors etc.
- ❑ Shocks are important features of the global economy. Steps for establishing the economic impact of a shock:
 - ❑ Describing the state of the economy;
 - ❑ Determine which variables (either demand or supply) are affected;
 - ❑ Detail the new equilibrium and how the shocks then propagate to different markets
 - ❑ Analyzing the policy responses that try to bring the markets to a path that is desired by the policymakers.

Tradeoffs and the Free-Lunch Conundrum

- ❑ Free lunch refers to an action that brings only benefits, but no costs.
- ❑ There are always tradeoffs.
- ❑ Example: Troubled Asset Relief Program (TARP). Bailout of US banks totaling \$700 billion. Many were harshly critical. TARP, like most economic programs, comes with costs and benefits to society. Just as there is no free lunch, there are no perfect policies that generate nothing but prosperity. Chapter 5 discusses the tradeoffs between bailing out banks and letting them fail, but they are never crystal clear.

Context-dependency

- ❑ Rare are the instances in which policy prescriptions are universal.
- ❑ Even for the same country, the best course of action may change over time.
- ❑ Examples of context-dependency: for country A austerity is warranted, while for country B fiscal expansion might be better; Thailand let its currency devalue when faced with a currency crisis —Malaysia chose to disallow capital outflows.
- ❑ Economic advice is context-dependent but is built on a solid understanding of international economic processes.