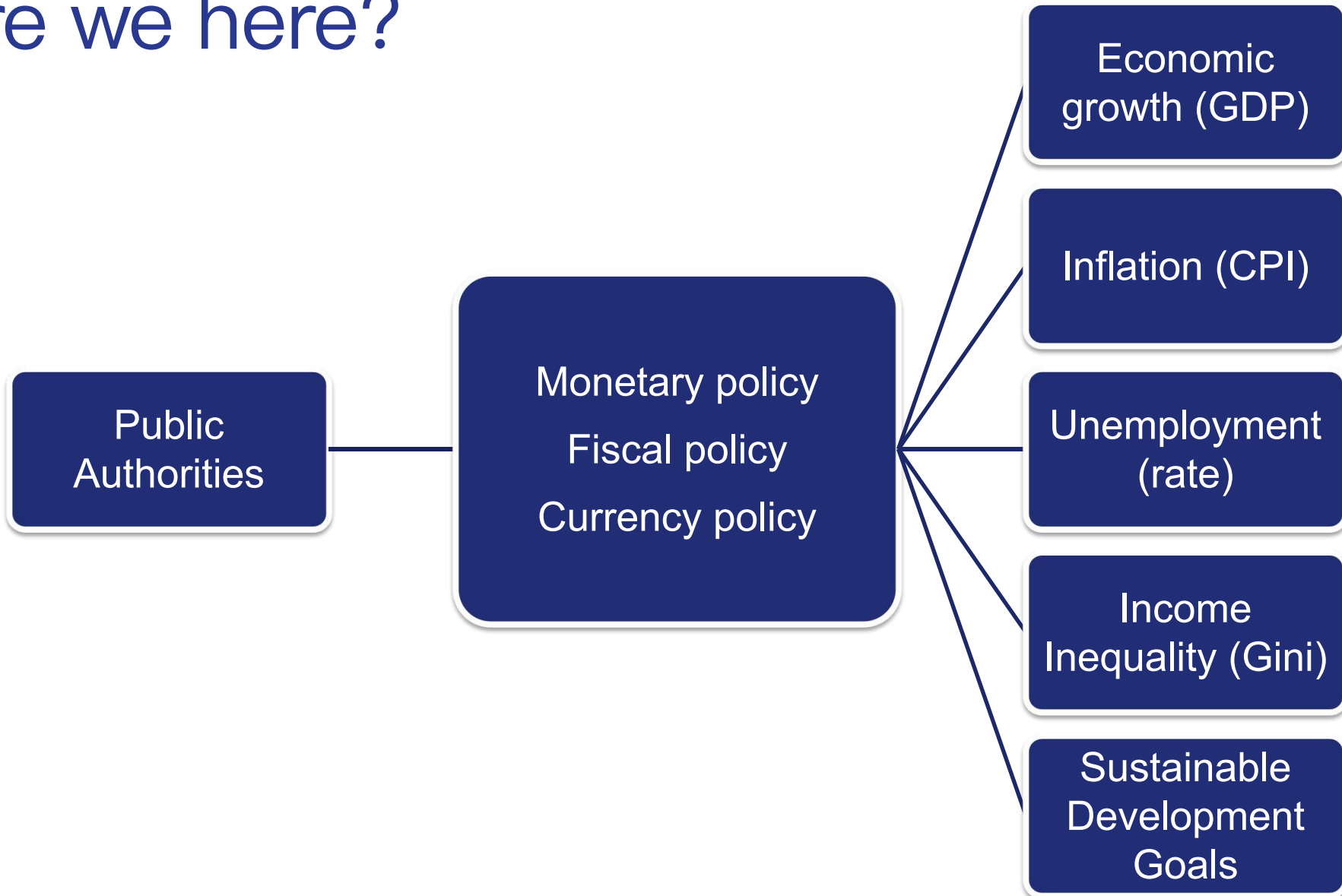


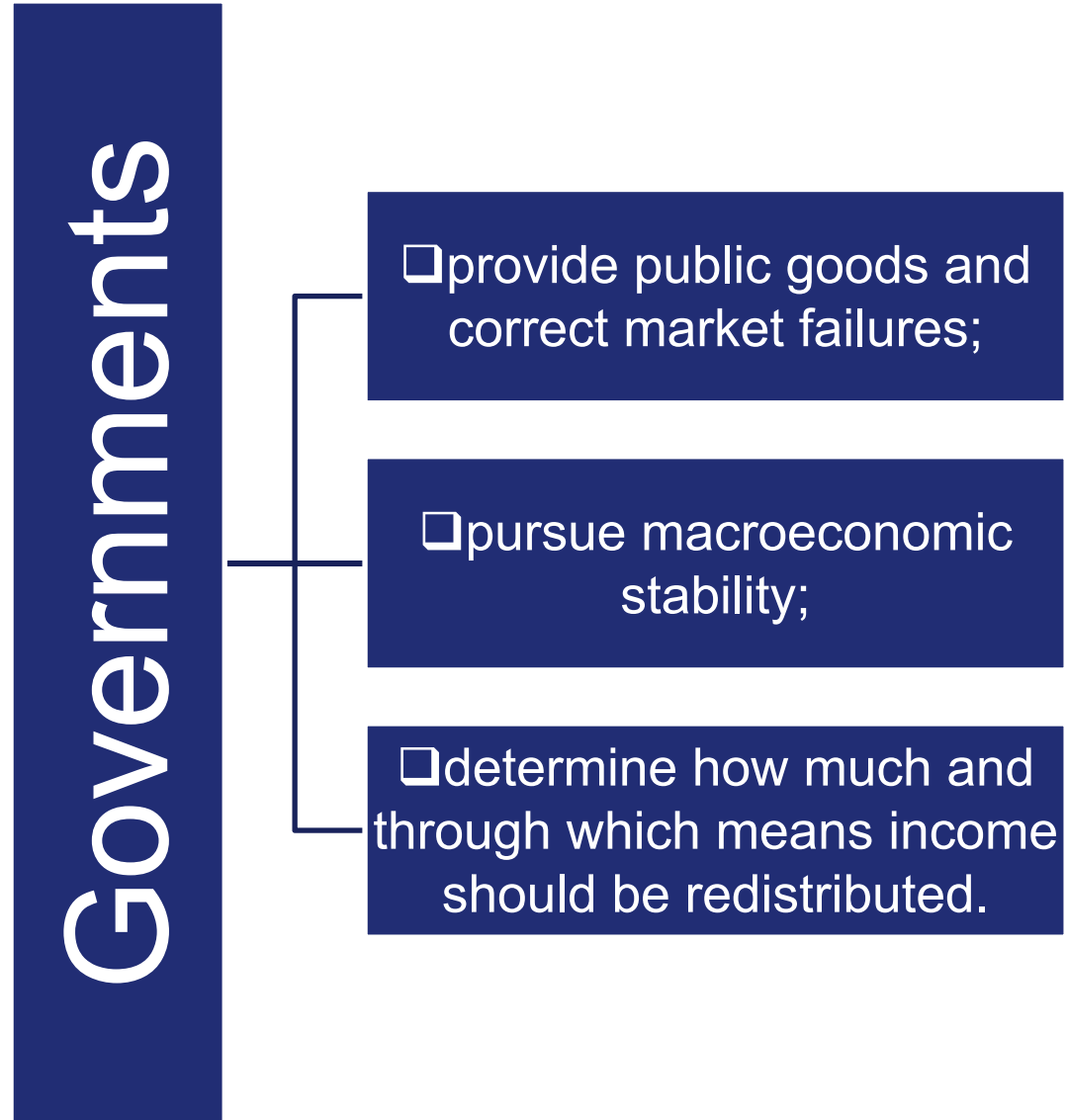
# The basics

## Chapter 1

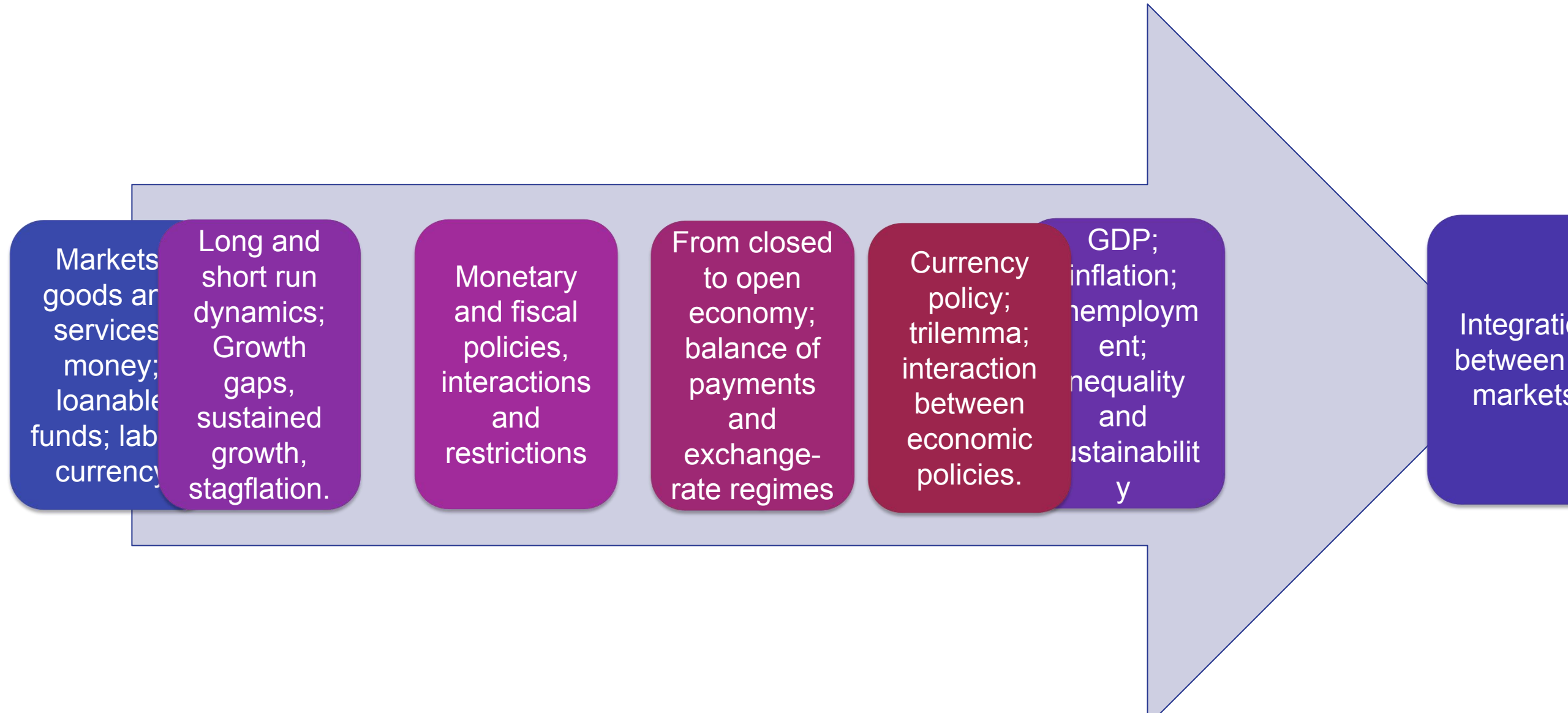
# Why are we here?



# Role of Governments



# Structure of the book



# 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.