Introduction

‘Economics is the study of how men and society choose, with or without the use of money, to employ scarce productive resources, which could have alternative uses, to produce various commodities over time and distribute them for consumption, now and in the future, among various people and groups in society.’

Paul Samuelson

Introduction

‘Economics is concerned with modeling the behavior of individuals and organizations—firms, nonprofit organizations, and so on—in market and nonmarket settings. Its models almost always assume that behavior is purposeful—directed at some clear goal—and it usually studies how diverse behaviors that have conflicting objectives are brought into equilibrium by market and nonmarket institutions.’

David M. Kreps

Introduction

Normative versus Positive Economics:

Positive economics describes the facts and behavior in the economy.

Normative economics involves ethical precepts and value judgements.

Introduction

• Two Principles of Economic Problem
  • Interdependence:
    • The principle that economic decisions are interrelated such that the consequences of a decision always spread beyond the immediate objectives of the decision.
  • Opportunity cost:
    • It is the economic meaning of the cost: the value of the next best alternative (in terms of the objective).

Introduction

Pitfalls in Economic Reasoning:

(i) Ceteris paribus (other things equal)
   - There is high-level interdependence among economic units. To simplify the analysis we assume other things equal.
(ii) Post Hoc Fallacy
   - ‘After the event’ does not necessarily imply ‘because of the event’.
(iii) Fallacy of Composition
   - What is true for a part is not necessarily true for the whole.
Introduction: The Market Mechanism

Market supply and market demand determine the price of the good and quantity bought and sold.

Introduction: The Basics of Supply and Demand

- Demand
  - The demand curve tells us how much consumers are willing to buy for each price per unit they must pay, ceteris paribus.
- Supply
  - The supply curve tells us how much producers are willing to sell for each price per unit that they receive in the market, ceteris paribus.

Introduction: The Basics of Supply and Demand

- Shifts in Supply and Demand
  - S and D curves tell us how much producers and consumers are willing to sell and buy as functions of the price they receive or pay.
    - When the price changes (ceteris paribus) we move along the curves.
    - But S and D are also determined by other variables.
    - If there is a change in other variables (ceteris paribus) the curves shift.

Introduction: The Market Mechanism

- Equilibrium
  - The two curves intersect at the equilibrium (or market clearing) price and quantity.
  - The market mechanism is the tendency in a free market for the price to change until the markets clear.
  - Market clearing because
    - There is no excess demand or excess supply.

Introduction

Microeconomics studies the economy ‘in the small’. It focuses on:
(i) The economic problems of individual consumers, business firms, nonprofit organizations and government agencies;
(ii) The incentives that motivate them to engage in economic exchanges with one another;
(iii) The results of their economic exchanges for particular goods and factors of production.

Introduction

Macroeconomics studies the economy ‘in the large’. It focuses on aggregate data.
Macroeconomic policy has four broad objectives:
(i) Long-run economic growth;
(ii) Full employment;
(iii) Price stability;
(iv) Stability in international economic relations.
Introduction – Issues
Long-run Growth versus Business Cycles

3.5 million YTL in 1923 (1987 prices)
4,266% increase in 83 years

Average Growth Rate 3.95%

Labor Productivity in Turkey
2.48 YTL per worker in 1923
7.05 YTL per worker in 2006

Historical Inflation in Turkey
What a 1 YTL could buy in 1923 could be bought with 13,690,842 YTL in 2006.
Introduction – Issues

Inflation

Unemployment versus Inflation

International Economy

Introduction – Issues

Macroeconomic Policy

• Monetary Policy

• Fiscal Policy

• Stabilization

Debate on Macroeconomic Issues

The Classical Approach


- It is based on the assumptions
  - that individuals and firms act in their own best interest
  - that wages and prices adjust quickly to achieve equilibrium in all markets.

Conclusion: no need for macroeconomic policy. Leave well-enough alone. “Laissez-faire” economics.
Introduction – Issues  
Debate on Macroeconomic Issues

• The Keynesian Approach
  • Names: too many interpreters to mention.
  • It assumes
    • that wages and prices do not adjust rapidly.

• Neoclassical synthesizers
  • various sub-species exist
  • They pick best elements of Classical and Keynesian approaches:
    • Economy is “Keynesian” in the short run but “Classical” in the long run.

• Monetarists
  • Names: Milton Friedman (1912-2006) and his “Chicago boys”
  • Quantity theory of money.
  • Friedman hates the Rational Expectations Hypothesis
  • monetary policy is potent but ....
  • policy maker makes timing errors (“long and variable lags”) and may exacerbate the cycle.

• New Classical economists
  • Names: Robert Lucas (1937-), Thomas Sargent (1943-), Edward Prescott (1940-), Robert Barro (1944-)
  • natural successors to the classical economists
Introduction – Issues
Debate on Macroeconomic Issues

- **New Classical economists**
  - flexible prices/wages, REH (or Perfect Foresight Hypothesis), full employment, efficient markets.
  - micro-foundations of macro-relations (e.g. investment demand, consumption demand, money demand, labour demand and supply)

- **Supply siders**
  - Names: Arthur Laffer, Robert Mundell (1932-)
  - radical conservatives
    - strong distrust of “the government” [Leviathan]
    - emphasis on distorting aspects of taxation
  - policy advice *too good to be true*: you can cut the tax rate without reducing government spending. The tax cut pays for itself—see the so-called Laffer curve.
  - Reagan loved it and ran huge deficits! Revisited by Bush Jr.

- **New Keynesian economists**
  - They derive their inspiration from John Maynard Keynes.
  - markets are prone to fail or to be incomplete
    - after initial hesitation acceptance of the REH (or PFH)
  - government can and should intervene in the macro-economy
  - keen attention to microfoundations