

An Intro to Intro to Econ

Amherst College

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Outline

- What is economics?
- How is “economic thinking” useful for understanding our world?
- How will this course inform our understanding of the two above questions?

The Starting Point : what is it?

- Economics is the study of human behavior, as are all social sciences. The difference between the social sciences is the methods they use to study behavior.
- Economic approach seeks to understand behavior by assuming that people when people make decisions, they have some goal in mind.
 - ▶ We typically assume the goal is stable over time and quantifiable. (Cost - benefit analysis, utilitarianism)
 - ▶ Many times choices are limited, and people pick the best that is available.
 - ▶ Following this approach to its logical conclusion gives new insights into to understanding, and improving, social phenomena.
- There are also bounds on the economic approach.

What is the point of modeling

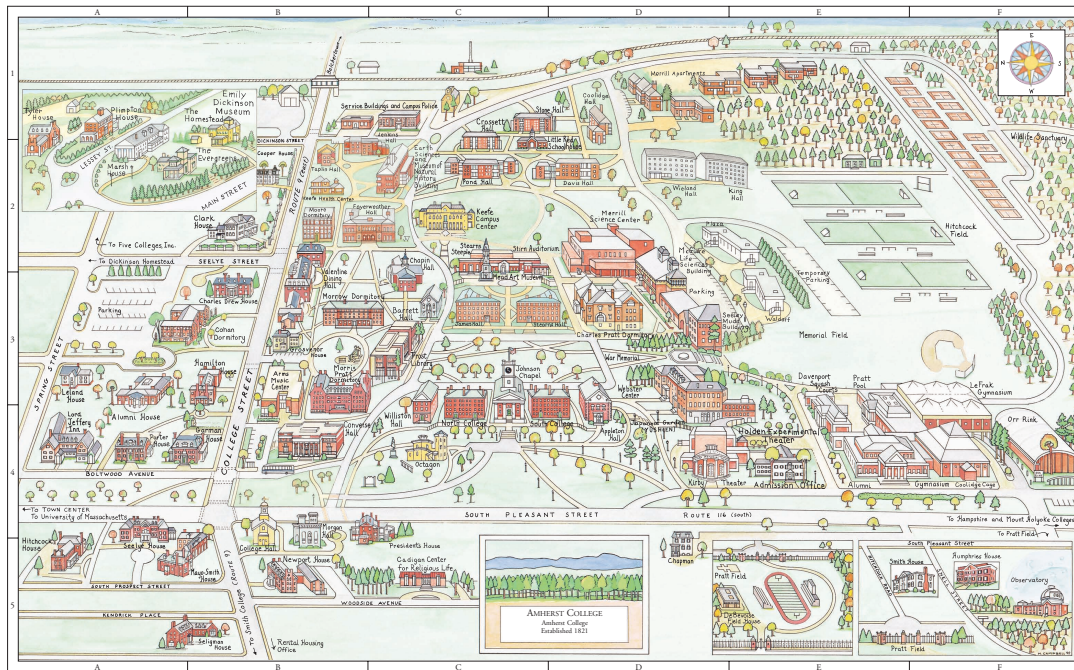
- Why do we make models?

I want to understand the connection between changes in the money supply and economic depressions. One way to demonstrate this connection would be for me to engineer a depression in the United States by manipulating the U.S. money supply. I think I know how to do this, but a real virtue of the democratic system is that we do not look kindly on people who want to use our lives as a laboratory. So I will try to make my depression somewhere else.

“What Economists Do” (Lucas, 1988)

What are models?

“All models are wrong, but some are useful” Box (1979)



Economics essentially attempts to make “maps” of human behavior. Premise is that we can make a decent enough (not perfect) map for our situation by “mapping out” the relevant incentives/values/options of the parties who interact.

Canonical applications

Theoretically

- Understanding the emergence and, in certain situations, “efficiency” of markets. (<https://www.youtube.com/watch?v=67tHtpac5ws>)
- There is no “good” election in a setting with three or more candidates to select. (Arrow’s theorem, <https://youtu.be/AhVR7gFMKNg>)

Directing empirical work

- Development benefit and understanding the marginal benefit of spending a dollar on one innovation over another. (see, for ex. <https://www.youtube.com/watch?v=8eJRRCBiTOs&t=475s>)
- Understanding the impact of accessibility to reproductive health care and early childhood lead exposure on later in life outcomes. (see, for ex. <https://freakonomics.com/podcast/season-8-episode-47/>)
- Quantifying the value added by good teachers. (<https://www.youtube.com/watch?v=NPvSosjdZYU>)

What are economic models?

- Typical elements:
 - ▶ Characters : cities, individuals, businesses, countries, some mix.
 - ▶ Possible decisions available to the characters.
 - ▶ Welfare consequences of possible outcomes.
 - ▶ An “equilibrium” or prediction of what happens.
- Characteristics:
 - ▶ Quantitative : Decision makers have some quantifiable goal, and they make decisions in pursuance of this quantifiable goal.
 - ▶ Reductive : Our basic models ignore many important features. This is for tractability and clarity.
 - ▶ A fairy tale that seeks to approximate reality in a way that adds depth to our understanding.

Our focus

- Much of our focus will study how markets/exchange/trading determines who buys/sells which goods/services. Who gets what and why?
 - ▶ What are the effects of raising the minimum wage?
 - ▶ What are the effects of trade protections like tariffs and quotas?
 - ▶ How can we regulate firms that pollute?
 - ▶ What are the welfare implications of taxing/subsidizing something?
 - ▶ How should government be involved in the regulation of industry?
- These are big big question for society, but also more limited than studying all of human behavior.

Essential intuitions guiding our study of markets

- People, places, cultures, societies, etc. are diverse. That means there are gains from trade to be had.
 - ▶ It is “easier” for a farmer in Costa Rica to grow bananas vs. asparagus.
 - ▶ It is “easier” for a farmer in Hadley, MA to grow asparagus vs. bananas.
 - ▶ If Hadley farmer likes to eat some bananas and Costa Rica farmer likes to eat some asparagus, then there are gains from trade to be had.
- So there are gains from trade to be had. What determines whether trade happens, and at what price?
- If there are gains from trade to be had, should we ever prevent trade? Should we regulate trade?

Much of the micro (and also macro) part of course

- Perfectly competitive markets model. Our most basic map.
- It is almost always “wrong”.
- It is incredibly useful, and applicable across a diverse range of applications.
- Foundational hypothesis : objects trade at some price. When there is a shortage (more demand than supply), price goes up. When there is a surplus, price goes down.

Conclusions

- If markets are competitive (i.e. shortages push price up, surplus down), then they will allocate resources in a way that maximizes the total benefit.¹
- Leads many to argue that markets are an important organizational force in society. Markets provide emergent order.
(<https://www.econlib.org/library/Essays/hykKnw.html>)

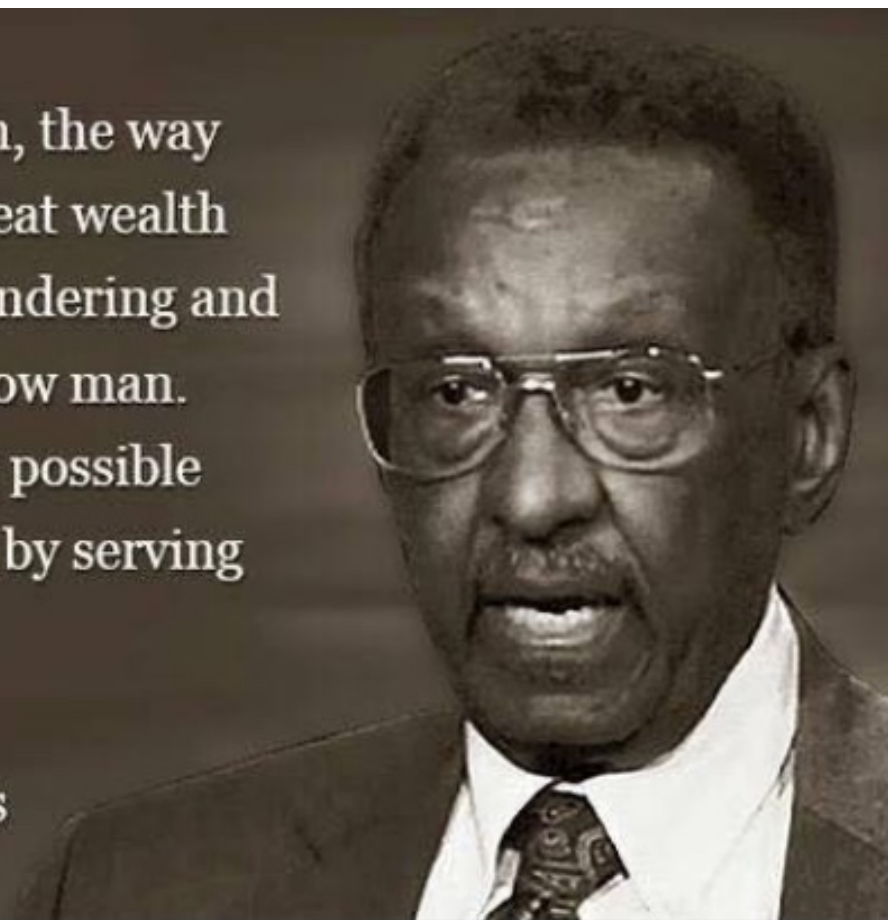
¹Terms and conditions apply.

Conclusions (?)

- Markets are a goodish type of thing.
- Information problem is really hard.
- Can lead to order, growth, innovation, at least in some domains.

“Prior to capitalism, the way people amassed great wealth was by looting, plundering and enslaving their fellow man. Capitalism made it possible to become wealthy by serving your fellow man.”

Walter E. Williams



Conclusions (?)

- Markets are badish type of thing.
- Can propagate inequity, while there are gains from trade, the gains are not necessarily split evenly.
- Can be hard to regulate externalities.
- Markets for bad stuff are emergent too. Sometimes they don't emerge in places where they should.

Conclusions

- Markets are. Thus, we should understand them and how we want to shape them (if at all).
- What about methodologically? Why is econ so preoccupied with markets? What happened to all human behavior?



- Markets provide an especially useful setting for demonstrating the usefulness of the economic toolkit.