

1. Introduction to Macroeconomics (part 2)

EE 212

Read: Case & Fair, ch. 5,7 ; LCR, ch. 21

January 2016

- 1 What is macroeconomics? (part 1)
- 2 What are the goals of macroeconomics? (part 1)
- 3 The brief history of macroeconomics (part 1)
- 4 Tools for understanding macroeconomic issues (part 2)
- 5 Tradeoff between macroeconomic objectives (part 2)
- 6 Basic concepts in understanding economic activities (part 2)

4. Tools for understanding Macroeconomics Issues

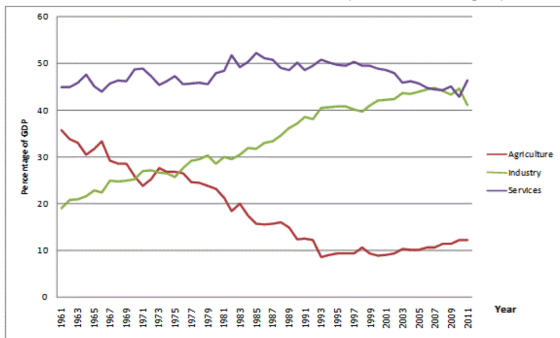
- Basic tools for investigating macroeconomic phenomena

4.1 Empirical tools

- Empirical =
- In economics, most empirical analysis are done quantitatively (through analysis of numbers)
 - Recording of how quantitative value of a variable change through time
 - Also, recording of relationships between variables
 - This is about finding correlation between variables
 - But needs to be careful that correlation does not imply causation

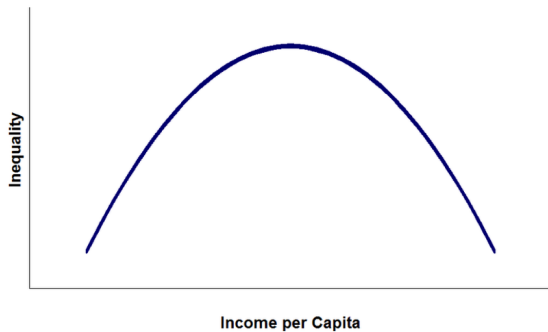
- Empirical tools (time-series)

Share of GDP in Thailand (Percentage) from 1961-2011



Data Source: The World Bank 2013
(<http://data.worldbank.org/country/thailand>)

- Empirical tools (regression)
Kuznet Curve

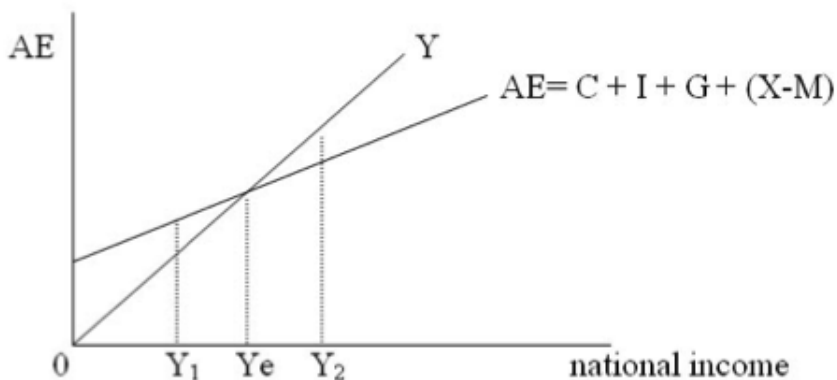


Theoretical tools

- **Quantitative Analysis** may not produce enough insights on “how things work”
- Economists construct “economic models” to do such a task
 - A model, proposing the nature of relationships between variables, is based on thought-experiments.
 - Assumptions are outlined, and through careful reasoning, a mathematical explanation is built.

Theoretical tools

- Economic Model : Keynesian model of income determination



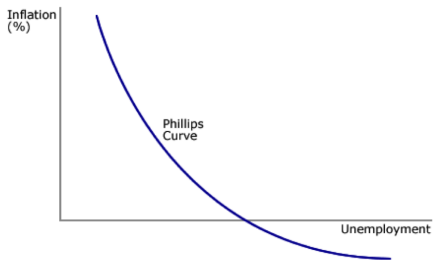
Historical tools

- In addition, knowledge of historical events also forms another route in which economic knowledge can be developed.
- This route can be indispensable in giving broader insight on economic phenomena. This is because it can provide a connection between economic, social, and political factors.

Example: “Kicking Away the Ladder” (Ha Joon Chang, 2002)
Historically, the Western developed nations had used trade protections and subsidies to support the growth of their industries. Such policies, in place throughout 18-19th century, contributed to its powerful economic position in the present. It seems, therefore, contradictory that these are the nations that ask developing countries to develop through “trade-liberalisation.

- The concept of trade-off is central to economics
 - Remember the Production Possibility Frontier (PPF)?
- What about the trade-off in macroeconomics?
 - Employment and inflation
 - Energy and environment
 - Efficiency and equality

- Trade off in employment and inflation
 - Phillips Curve



5. Tradeoff between macroeconomic objectives

Trade off in efficiency and equity

- Programs to promote equality comes at the expense of distorting incentives to work and, thus, reduce efficiency in the economy.
 - For example: unemployment benefits
- But we have to keep in mind that several notions of “trade-off” are contestable.

Finding macroeconomic data online

- From the World Bank website, we can check for data for Thailand and other countries
 - <http://data.worldbank.org/country/thailand>
- Example:
 - We can find data on unemployment and inflation, and plot them as time series.
 - We can also observe their relationship overtime.

6. Basic concepts in understanding economic activities

- **4 essential macroeconomic activities:**

- Types of capital

- Natural capital
- Manufactured capital
- Human capital
- Social capital
- Financial capital

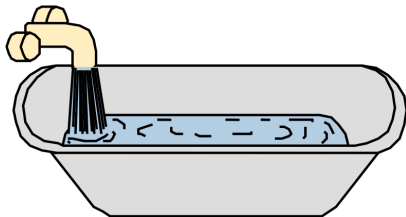


6.1 Stock VS Flow Variable

- Stock VS Flow Variables
 - Stocks
 - Flow
- Flows change the level of stocks
- Most macroeconomic variables can be categorised into stock or flow variables

Examples

- Income =
- Wealth =
- Investment =
- Capital =



- **Investment VS Depreciation**

- Investment is primarily the activity of resource maintenance
- Depreciation occurs when Manufactured assets, for example, wear out and lost their usefulness overtime.
- Resource maintenance activities help to keep up the quantity and quality of important capital stocks.

- **Consumption** : The final use of a good or service

- Consumption is frequently contrasted with

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- **Production** = conversion of resources into goods and services.
 - Production converts "inputs" into "outputs"
 - Inputs include materials that become part of the produced good, supplies that are used up in the production process, and labour time.
 - But there are flow of services, arising out of capital stocks, that will not be used up.
 - These include

6.2 “Nominal VS. Real” Value

- In economics, “nominal” value refers to the value expressed in monetary terms, i.e. in the units of a currency.
- “Real” is a value that is adjusted from the nominal value to remove the effect of a change in price over a period of time. For example,

6.3 Important Concept on Distribution

Distribution the allocation of products and resources among people
Macroeconomists are usually particularly interested in

- Who receives income? Labour VS Capital Labour income is compensation received by workers in the form of wages, salaries, and fringe benefits Capital income include rents, profits, and interest
- Questions usually arise

- Tim Cook (Apple CEO) VS A Chinese labour (who produces apple products)



The Apple CEO's pay was \$4.2 million in 2012 (Forbes)



A salary for an entry level worker in Foxconn factory is approximately \$ 3600 per annual in 2013 (Dailymail, UK)

The difference is just 1,166 times

Measurement of income distribution 20:20 Ratio (income of the richest 20% divided by that of the poorest 20%)

Lorenz curve = a line used to portray an income distribution, drawn on a graph with percentiles of household on the horizontal axis and the cumulative percentage of income on the vertical axis.

Gini ratio =

- Gini ratio (or coefficient) = $a/a+b$

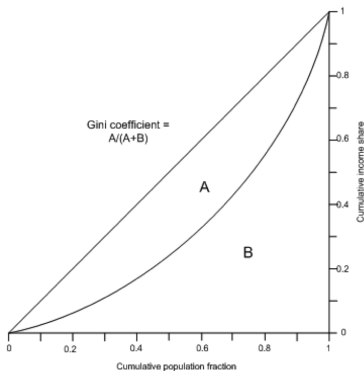
- If the gini is higher, the economy is more unequal

- Thailand Gini Coefficient (world bank)

- 1990 = 45.27
- 1996 = 42.9
- 2000 = 42.84
- 2006 = 42.35
- 2009 = 40.0

- Other countries

- Cambodia 2009 = 36.0
- South Korea 2007 = 31.3



- Wealth inequality – the distribution of wealth, i.e. what people own in assets or debt
- Example: <http://business.time.com/2014/01/20/worlds-85-wealthiest-people-as-rich-as-3-5-billion-poorest/>
- Important concepts on distribution: taxes VS transfers Taxes is the main venue for the government to raise revenue.
- Transfer are flow of money, goods, or service from the government to its people. It forms an important part of the roles of a government in providing welfare.