# W1-1 INTRO

Economic Systems:

* Tradition
* Command
* Market

Decisions made by (conflicting goals):

* Firms: Max profit by keeping costs/wages down and output high
* Households: Maximize leisure and incobe
* Government

Decisions are made in 2 markets:

* Goods and services for final sale
* Factor markets – intermediate goods:
  + Labor
  + Land
  + Capital

Accounting cost: out of pocket expense for performaing an activity

Sunk Cost: Cost that is not relevant for a decision

Economic cost: All costs that are relevant – exclude sunk costs; include opportunity costs (not all financial)

Positive statement: Can be verified

Normative statement: Subjective judgement

Prediction: general statement about the future

Forecast: Detailed probability estimate of future events used to assess risk based on currently known facts.

Variations: Economists have different views about positive matters, some open to interpretation. Variations are beneficial to maket participants because it provides a more detailed assessement of risk factors. Event risk – does not diminish value of forecast)

# W1-2 Unemployment

Unemployment (U): Counted as unemployed if:

* Over 15 years old
* Actively seeking work
* Available for work

Employed (E): Have part or full time work

Labor Force (LF): E + U

Unemployment Rate (UR) = U / LF

Types of unemployment (U = Fr + St + Cy):

* Frictional (Fr): In between jobs / new to labor force due to normal business conditions
* Structural (St): Unemployed due to permanent declines in jobs caused by long term changes in industry
* Cyclical (Cy): Temporary unemployed due to business cycle
* Seasonal: Predictable job loss due to seasons (Assume UR adjusted for seasonal changes)

Natural rate of unemployment: UR if there were no cycles (since St + Fr are assumed permanent):

NR = (Fr + St) / LF NR = (U – Cy) / LF

Full unemployment: Impossible since always Fr + St. If economy operating at full employment, UR = NR

Measurement problems:

* Unrealistic wage expectations: remains unemployed because expects better. Inflates UR
* Discouraged workers:
  + when leaving the workforce in recessions = reduction of unemployment rate
  + When starting to look for work after recession = increase in UR
* Part/Full: 1 Parent lose job so 3 kids get part time jobs = reduction of UR

Costs of unemployment:

* Lost of output (Okun’s Law): 1% drop in UR = 2% drop in GDP
* Loss of human capital / job skills
* Increase in crime / healthcare
* Loss of tax revenues

# W2 Inflation

Price Level: Average level of prices measured by a price index

Inflation Rate: Rate of growth of price level. Degrees of severity:

* <10%: Creeping Inflation
* >10%: Double Digit Inflation
  + 20-60: Galloping Inflation
  + 50+/month or 600+/Yr: Hyper Inflation

To calculate price index, use Quantities from reference year

Types of price index:

* CPI: Consumer Price Index
* PPI: Producer Price Index
* GDP Implicit Price Deflator Index: Average of all prices included in GDP

Effects of inflation:

* Individuals attempt to protect purchasing powers by liquidating financial assets and converting them to real assets. Reesulting excess demand causes shortages and more inflation
* Savings fall, less money to borrow, price of borrowing (interest) increases, less investments so productivity decreases

Causes:

* Excess demand/spending: Can be due to expected inflation. Eventually, as more workers are hired, SHORTAGES of skilled workers and materials will happen and therefore prices begin to rise faster than before and the inflation rate increases. This usually happens when UR -> NR; typical business cycle phenomenon: as the economy expands the unemployment rate begins to drop, when workers and materials are in short supply the inflation rate begins to increase. Policy solutions to this problem are straight forward.
* Supply Shocks Sudden country wide increase in key production cost
* Excess supply of money due to government debt