

Lessons of Macroeconomics

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After a semester of intermediate macroeconomics, a number of broad themes have emerged that are applicable to problem solving / analysis in most every profession. Listed below are seven (seven because seven is a lucky number) general lessons that I hope you will forever remember in your work after economics. In the short run (for your exam), knowing how to derive the Solow Model will make you better off; but in the long run (what matters most), you will be better off if you are simply able to apply economic logic to real world problems. In the end, it does not matter if you become an economist, but it is important to think like an economist.

Below I list seven economics lessons and provide an economic justification for each. Finally, I generalize each concept to apply to most any real world situation. If you can internalize each of these lessons, you will realize what it means to think like an economist.

The seven lessons are as follows:

Lesson 1: Macroeconomics is inherently complex.

Justification: As is evident from this course, economic theories trying to explain the behavior and reaction of nations require a complex set of assumptions and ideas. We have seen that in order to model the real world, we can continually add more parameters to a model in order to give it different interpretations. The macro-economy is not a toy economy.

General Application: The real world is inherently complex.

Lesson 2: An economic policy that is good for the long run may hurt the short run.

Justification: Adopting a certain tax, spending, inflation or unemployment policies may improve short run income, but may be harmful to economic growth (the long run). Conversely, to stimulate long run economic growth, it is sometimes the case that we must sacrifice income in the short run.

General Application: Considering both the short run and long run is important.

Lesson 3: A nation's economic policies focus on improving the short run.

Justification: Economic policies regarding unemployment and growth are often short-term policies with little consideration of the long run. This is the case because the democratic system of elections causes politicians to maximize the conditions of voters – now. Politicians are reluctant to make people worse off in the short run to benefit the long run. The Federal Reserve System tries to eliminate this problem.

General Application: Politics matters.

Lesson 4: Economic decisions come with tradeoffs.

Justification: The Phillips Curve is the economic depiction of the tradeoff between the output gap and inflation. Furthermore, there are tradeoffs between high inflation and low unemployment. Economists focus on how a number of variables move simultaneously.

General Application: Confront tradeoffs.

Lesson 5: Relative comparisons of economic variables are important.

Justification: Comparing data over time or relative to another parameter is more useful than an interpretation of a parameter standing alone. Relative prices are important for trade. Comparing consumption relative (as a ratio) to GDP is more valuable for making comparisons.

General Application: Relativity is necessary to compare.

Lesson 6: Economics is dynamic.

Justification: The world is continuously changing and thus economic models must be able to reflect this change. Static models often fail to be accurate predictors of dynamic processes. For this reason, economists strive to have dynamic models.

General Application: The real world is dynamic.

Lesson 7: The assumptions underlying an economic model are critical to its conclusions.

Justification: Economic models make assumptions about the real world in order to simplify the model. Disagreement with a model is often the result of disagreeing about whether the assumptions are true. For example, we assume the AS/AD model does not include net exports. After adding net exports to the model, we see this assumption is not critical to the conclusion, but only changes the economic logic underlying the model.

General Application: When disagreeing with someone, analyze the validity of his or her assumptions.