

SPEA-V-202
Contemporary Economic Issues in Public Affairs

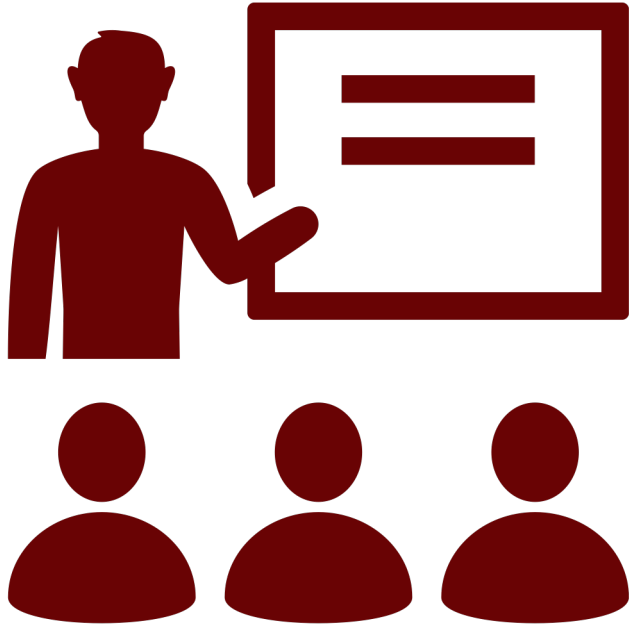
Introduction

Luis Navarro



INDIANA UNIVERSITY BLOOMINGTON

Welcome to V-202!



- **Instructor:** Luis Navarro
- **Contact:** lunavarr@iu.edu
- **Class Meeting:** TT 8:00 – 9:15am
- **Room:** PV 169
- **Office Hours:** TT 9:30 – 10:30am
- Syllabus available at Canvas.



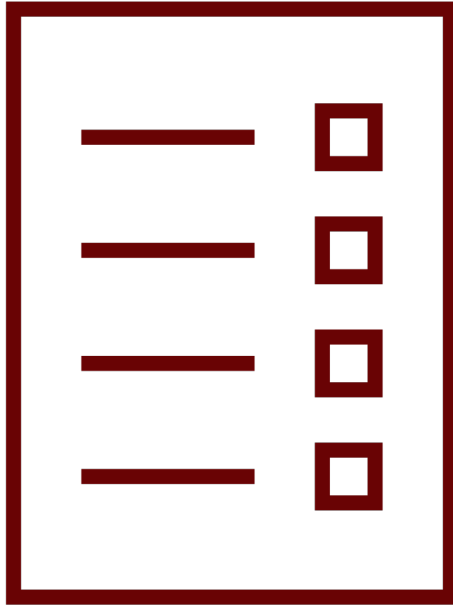
About Me:



- **Current:** PhD Student at O'Neill. Public Finance and Policy Analysis.
- **Research:** Financial Management, Fiscal Federalism, Local Tax Policy and Municipal Debt Markets.
- **Education:** BSc Economics (Finance Minor) – Class of 2016
- **Professional Background:** economist at the Ministry of Finance and financial advisor for government organizations (federal, state and local).



Syllabus



Let's read the syllabus and talk about:

- Learning outcomes and expectations.
- Ground rules.
- Readings and course material.
- Assignments, exams, and grades.



Economics: Intro

Economics is the social science that studies decision-making under scarcity.

Decision-making

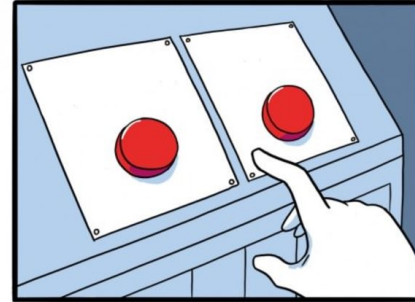
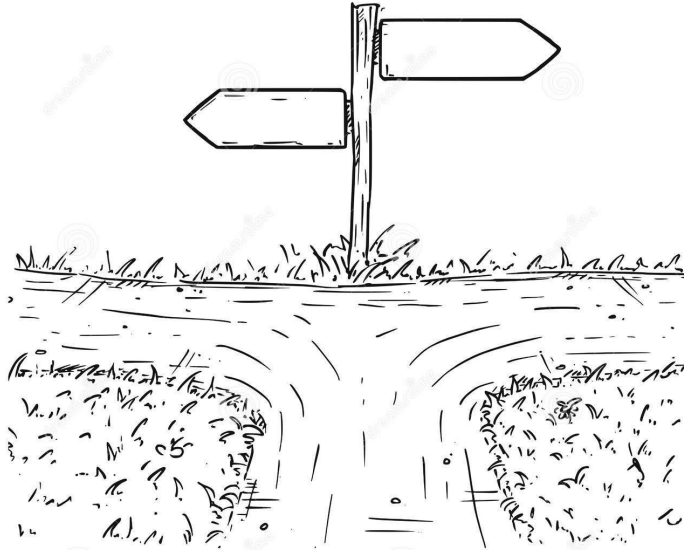
All about **incentives** and the **allocation of resources** in the economy

- Which cereal do you buy at the store?
- How many hours do you work?
- How much do you save?
- Which program gets more funds from the federal budget?



Key Concept: Opportunity Cost

“Two roads diverged in a yellow wood, and sorry I could not travel both...”
Robert Frost, The Road not Taken



JAME-CLARK.TUMBLR



Key Concept: Opportunity Cost

Decisions have trade-offs: every choice involves the sacrifice not choosing another alternative.

- *Pizza or sushi?*
- *IU or Notre Dame?*
- *Study or party?*
- *Policy analyst or entrepreneur?*
- *More or fewer taxes?*
- *Increase or reduce CO2 emissions?*

Opportunity Cost

The benefit of the second-best.

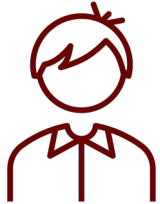
Opportunity cost is what you give up when you make your decision.



Key Concept: Opportunity Cost

Opportunity cost depends on each decision and on each individual.

- What is the opportunity cost of allocating one hour of your time to play video games?



Student

Completing the readings for the next econ class.



Worker

Stop earning one hour of salary.

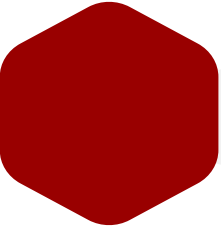


The President

Stop drafting America's next big policy.



Economics: Intro



Economics is the social science that studies decision-making under scarcity.

Scarcity

Not enough to satisfy demand when accessible at no cost.

- Economics deals with the allocation of scarce resources.
- Allocation of resources is done through the combined decisions of individuals, firms, and governments.



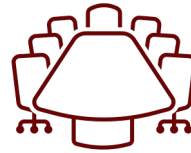
Market Economy

Allocation of scarce resources takes place by the interaction of **economic agents** via **market exchange**.

Economic Agents



Households



Firms/
Organizations



Government

both suppliers and
consumers in the
market economy.

Market Exchange – Market Economy
consumers purchase goods and services from suppliers



Economics and the Government

Unlike households and businesses, the government has additional roles in the market economy.



- ✓ Buy and sell goods and services.
- ✓ Provides specific goods, not provided by private organizations.
- ✓ Has the authority to pass and change regulations.
- ✓ It can change the rules of the game.
- ✓ It can impose taxes/subsidies and change people's incentives towards buying/selling.

Our plan: use economic theory to examine the role of government intervention in the economy.



Economic Analysis of Public Policy

Key questions that we will be exploring along this course:

- Why does the government implement some policies over others?
- Are we better off with the implemented policy, relative to the case of no intervention? What about relative to the case of a different policy?
- What are the intended (and unintended) effects of government actions on human behavior? In particular, in key outcomes for society: education, health, security, economic growth, income inequality, pollution, etc.
- What are the main economic concepts to keep in mind when analyzing public policy?
- What are the limitations of economic theory to analyze public policy? What things remain unanswered?



Economic Models

We will use economic theory to try to answer such questions.

- **Models are representations of reality:** a model is as good as it describes accurately the phenomenon of interest. Simplicity vs Realism.
- **Positive Analysis (what will happen):** The model will provide some predictions about the effect of one economic variable on another one.
 - Upon an increase on the price of healthcare, mortality is likely to rise.
- **Normative Analysis (what should happen):** The model could be used as benchmark to test to which extent policies depart from “the ideal scenario”.
 - Should government provide universal healthcare?
 - Economics provides only a partial answer. Some dimensions of reality escape the scope of economic models.



Thinking like an economist

- **Always think at the margin:** what is the benefit of drinking one more beer? Increasing one percent the income tax rate?
- **Caeteris Paribus:** markets have a lot of moving parts. To analyze the effect of one factor, we need to keep everything else constant. *Caeteris Paribus == everything else held constant.*
- **Our favorite answer:** “it depends”. When asked about the effect of some policy we always need to ask: compared to what? Choose the counterfactual carefully.
- **Intended and unintended consequences:** distinguish between the nature of policies’ effects on the economy.



For next class:

- **Readings:** GS Appendix A.



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