

Econ 110: Introduction to Economic Theory

19th Class

3/4/11

go over test; show grade curve, hand out answer sheet; can look at individual problems after class

show couple of graphs on fluctuations

discuss labor market/unemployment rate report from yesterday and this morning

http://money.cnn.com/2011/03/03/news/economy/initial_claims/index.htm

<http://www.bls.gov/news.release/empsit.nr0.htm>

http://money.cnn.com/2011/03/04/news/economy/february_jobs_report/

show the circular flow diagram at http://en.wikipedia.org/wiki/File:Circular_flow_of_income.jpg

we'll build up sector by sector just as the diagram does

before we start on that, let's look at some of the national income and product accounts

Can find these at the U.S. Bureau of Economic Analysis (BEA) website
(BEA is part of the Dept. of Commerce)

<http://www.bea.gov/national/nipaweb/index.asp>

under frequently-requested tables, take a look at Table 1.7.5 on the relationship of GDP to Income, and Table 1.1.6 on the components of GDP (look at annual data, 2009)

then for GDP, look at quarterly back to 2007 to see recession effects—see how components fluctuate)

so note that GDP has four main components:

$GDP = C + I + G + NX$ (consumption + investment + government spending + net exports)

$NX = X - M$ (exports – imports)

but how do these totals get determined?

Recall that GDP is a measure of our total output

so these components are all parts of AD as well

but GDP can also be represented as payments to the factors of production

so income $Y = \text{wages} + \text{profits (rent of capital plus economic profit)} + \text{land rent}$

and in equilibrium output value = income

Let's start setting up some theory to represent these amounts and how they interact

We'll start with a very simple model in which there is no government yet and no interaction with other countries, so a closed economy model

So in this model aggregate demand will just have two components, consumption and investment

$$AD = C + I$$

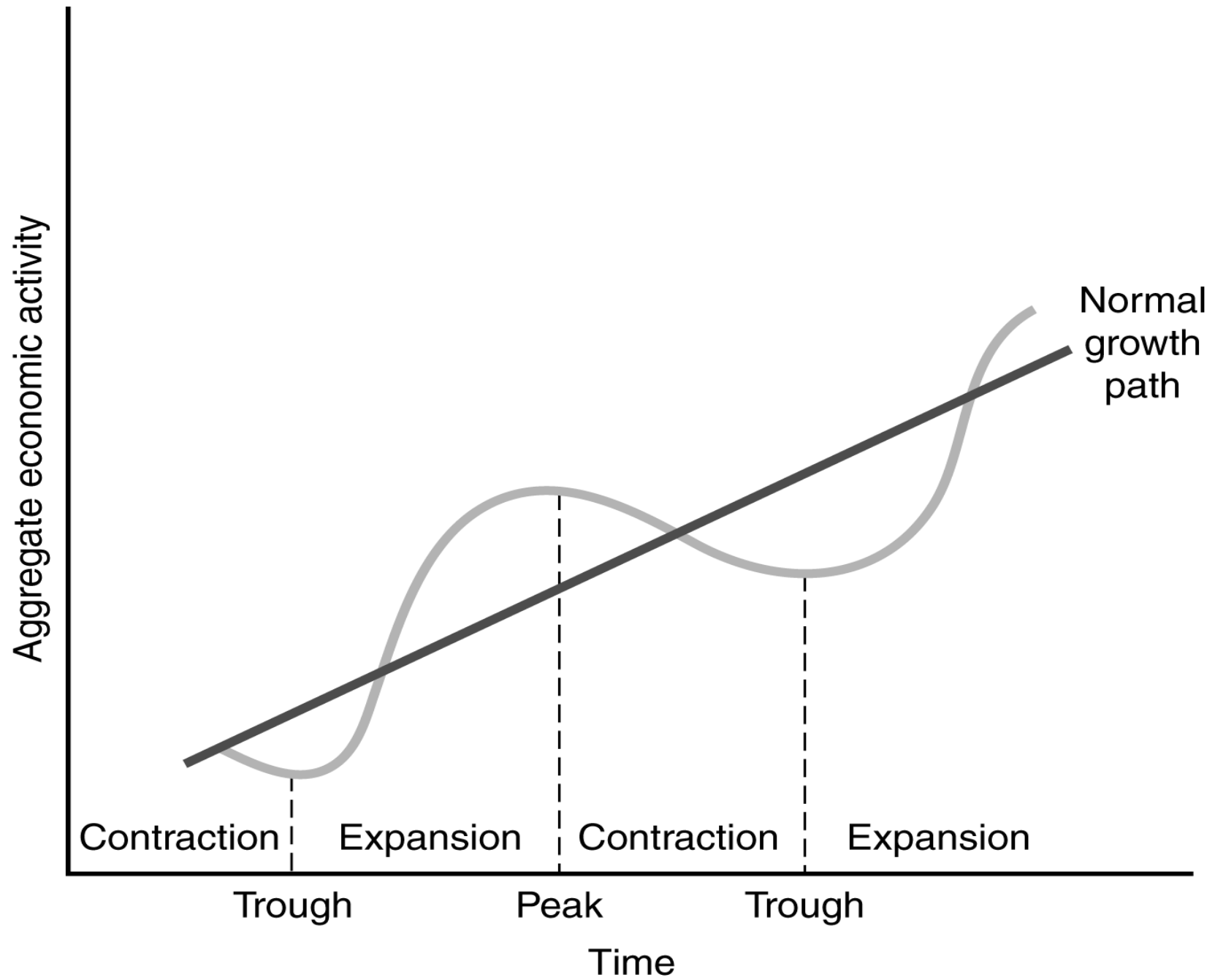
just as with an individual, the total amount that we spend has to equal our income Y

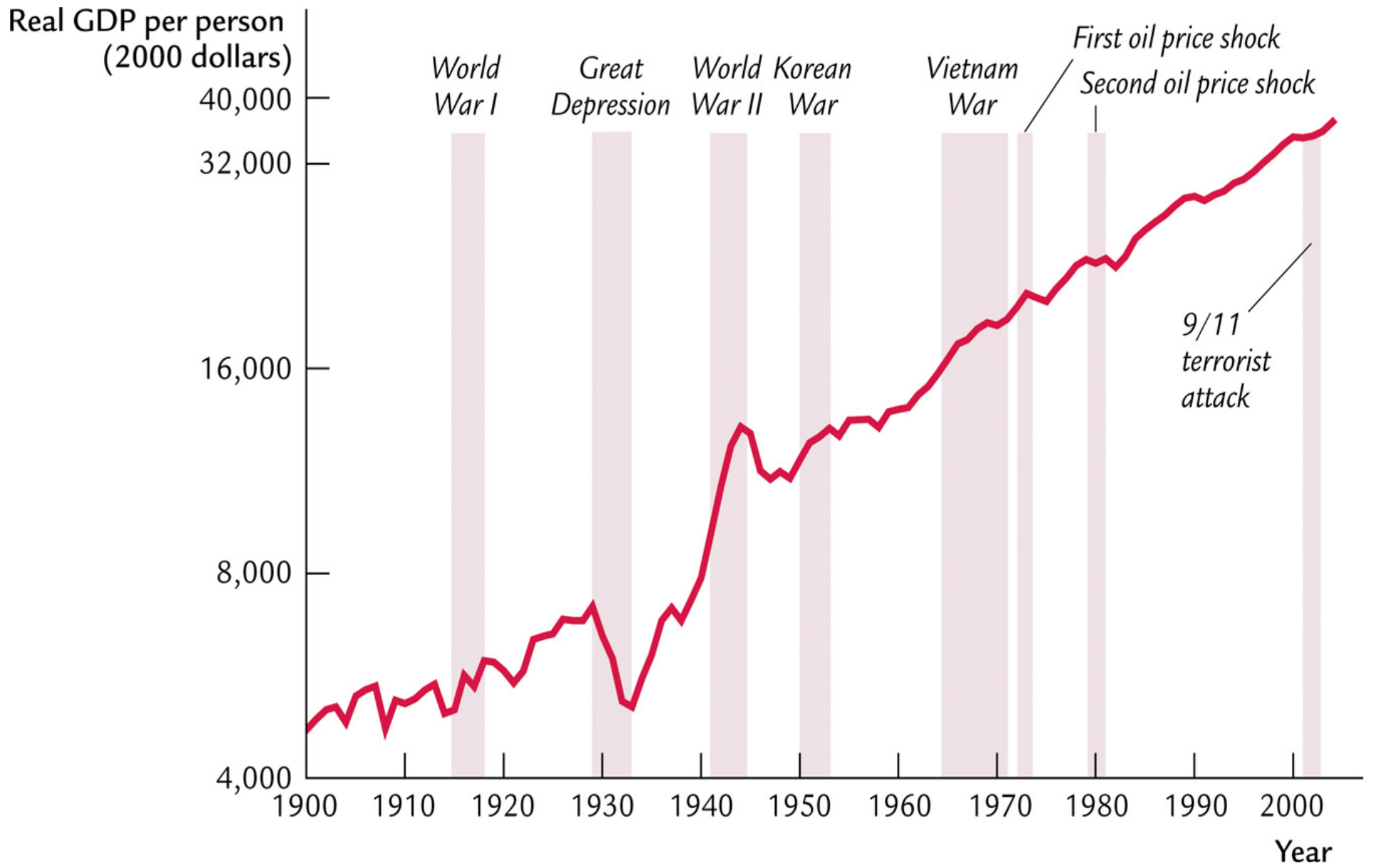
so in equilibrium $Y = AD$, so $Y = C + I$

that might seem really obvious, but recall that the people making consumption decisions are different from the firms making investment decisions, so how do the two sets of agents coordinate?

basically in our simplest model, C will need to be a function of Y to adjust
Thus the levels of Y and C will adjust mutually to achieve equilibrium.

Next class we'll start building up this model.





100-50=50 class range
84 class median
91-74=17 class inter-quartile range
82 class mean
12 class standard deviation

<u>scores</u>	<u>% of class in cell</u>
90-100	30%
80-89	36%
70-79	19%
60-69	10%
50-59	5%
40-49	0%
30-39	0%
0-29	0%

<u>grades</u>	
99-100	A+
94-98	A
90-93	A-
86-89	B+
79-85	B
73-78	B-
67-72	C+
61-66	C
56-60	C-
53-55	D+
50-52	D