Approach of this Course: Objective Economic Analysis

What type of bird are you?

One of the bigger issues concerning the macroeconomy in recent years has been monetary policy. Some policymakers/economists are considered hawks (worried about inflation) while others are considered doves (more concerned about economic growth and employment). While not trying to pick on anyone in particular, the most prominent hawk on the Fed is Charles Plosser (President of the Philadelphia Fed). Here's an excerpt from Barry Riholz' blog:

"Charles Plosser of the Philadephia Fed; if you've been following these things, you know that Plosser has been warning about imminent inflation since the beginning of the crisis. He did it in 2008; he did it in 2009; he did it in 2010; he did it in 2011; I'm getting tired here, but you can easily find him doing the same in 2012 and 2013. And he has of course been wrong all the way — but he's doing it again."

An example of a dove is Scott Sumner, who has been critical of the Fed for conducting policy that is too tight since the start of the financial crisis. Though it's OK to be a dove or hawk at times, there may be a problem if one is always a dove or hawk, regardless of circumstances (Scott Sumner would say unique circumstances related to the financial crisis have led to his position). The same holds true for issues other than monetary policy. If someone can be counted on to say the same thing (recommend the same policy) regardless of what's happening in the economy, it raises questions. In this class, rather than hawks or doves, we're aiming to be owls - making wise decisions! Understanding how the economy operates and then evaluating it's current condition before drawing conclusions.

There is no shortage of commentary regarding today's economy. It seems like there's a lot of opinions from which to choose. How can you be sure that you are getting an objective perspective about the economy? Is there such a thing as objective analysis or is economics the same as politics (just one person's opinion vs. that of another)? The rest of this page is not intended to put down others, but instead emphasize the need for objectivity when analyzing the economy. By the way, economists agree on many key issues (link).

Beware of Bias

Nowadays, there are more people than ever before providing commentary about the economy. In many cases, they are political activists trying to persuade people to believe a particular ideology. That doesn't mean that their view is incorrect, but they may not be economic experts. It seems that the "economists" who get the most attention are those who make the most extreme statements or consistently present a perspective from a particular political point of view. Many people have already drawn their conclusions and seek support for their point of view. For example, someone who is a conservative will seek an expert who always presents a conservative position. Why did we have a financial crisis? 'It's the government's fault - it's too big, intervened too much, etc.' Should the government have stepped in to stabilize the financial system? 'No, the big banks should have gone bankrupt, government should cut spending during a recession, etc.' Liberals seek someone to help them defend their point of view. 'The financial crisis was due to greedy bankers who should be heavily regulated or even nationalized. The government should increase funding for industries that it thinks should lead the economy into the future, etc.' Should you begin your research of a topic by starting with the conclusion or is it better to conduct research prior to drawing conclusions? When making business decisions, should you stick with your presupposition or determine what's best for your company?

Economics, not Politics

If you are looking for a political class focusing on debates, you are going to be disappointed. The approach taken in this class is to try to be as objective as possible. As MBA students and business people, it's important to understand how the economy behaves in the real world. If you fail to look beyond your ideology, you're probably going to have a distorted view and may not understand the behavior of the economy. There are areas of debate within economics, but most objective economists agree on the core behavior of the economy. The primary focus of this course will be to develop a solid, practical understanding of the economy so you can make better business decisions and also be able to separate bias from sound economic analysis. Who is to say what's objective and what's bias? We're going to take an empirical look at the economy to help develop a systematic approach to understanding the economy. In other words, rather than presenting a theory or just stating a opinion, we'll examine how the economy behaves in the real world and why it behaves as it does.

For example, some bloggers and TV commentators who claimed to be experts predicted that inflation would be out of control in the US in 2009, 2010, 2011, 2012, 2013, 2014, ..., as a result of how the Fed responded to the crisis in 2008 and afterwards. Objective economic analysis, including the historical behavior of the economy, suggested that inflation would remain under control. In the end, sound economic reasoning turned out to be correct; inflation has remained under control. Why? We'll consider that issue later. What if your bias led you to follow a commentator who said inflation would be out of control and you made business and personal decisions based on that prediction? For some, having an uninformed opinion could make them lose an argument, but for others, it can severely hurt their business or their career. That's why it's critical to have a solid understanding of the behavior of the economy prior to forming conclusions. Sometimes it gets complex and difficult, but using sound reasoning gives you a better chance of being correct as well as being able to understand if there's a need to adjust your perspective as new information becomes available.

Experts Who Predicted the Crisis

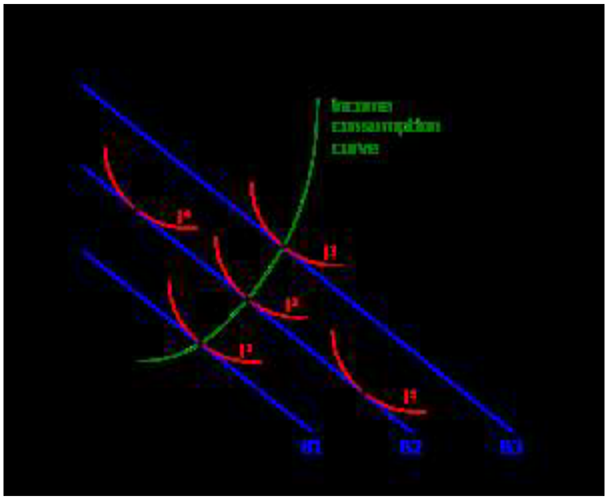
There are some who have predicted 10 out of the last 0 depressions and may claim to have gotten this one right (but not the last 9 or 10 wrong). Beware those who may possibly have gotten one right, but had poor reasoning or who were wrong for years and years and years and ...

Nobel Prize

A Nobel prize in economics is awarded for contributions to one aspect of economic theory, not the award for top overall economist for a particular year (not the MVP or MVE). Economists specialize in specific areas of economics; some have expertise in monetary policy, some in financial economics, international economics, public finance, industrial organization, econometrics (applying statistics to economics), and much more. For example, one of the most outspoken Nobel Prize winners is Paul Krugman, who writes a column for the NY Times. He earned his Nobel Prize for theoretical work on the reasons for international trade. That doesn't

Times. He earned his Nobel Prize for theoretical work on the reasons for international trade. That doesn't make him the top economic expert on monetary policy, banking, etc. His column has a byline, "Conscience of a Liberal", so he's being honest in noting the bias of his column. This is not intended to pick on him, but to make the point that earning a Nobel Prize in International Trade does not make one the most respected economist on all issues; it also shows how one can allow political bias to influence their perspective.

"An Economist is Someone Who Looks at Reality and Wonders How It Works in Theory"



Some economists tend to be more theoretical while others are more applied. A theoretical framework is essential to understanding how the economy is likely to behave, but it may miss how it is likely to behave in unique circumstance like today's economy. Likewise, someone who's applied but forsakes theory may not understand the key principles that explain the behavior of the economy (link). I attended a teaching economics focus group years ago and an economist who specialized in economics education made the statement that our most pressing need as professors is to help students understand graphs. If you've had classes in economics before, you probably remember many graphs, but not much economics. Graphs can be useful, but unfortunately many students get confused by graphs or focus on the graphs instead of the economics. In this class, we'll examine the concepts and principles without using graphs (OK, we may sneak in a supply and demand graph for the visual learners among us, but you can understand the concepts without the graph!). The hope is that this will help you understand the economics and how to apply it instead of getting bogged down with the method.

While some get bogged down in theory, others react to daily releases of data without having a systematic understanding about how the economy works. That may lead some to think the economy is experiencing a strong recovery one day and then worry about a double-dip recession the next. For example, many commentators were stating that the US was experiencing a V-shaped recovery in early 2010, based in part on a strong report about economic growth in late 2009. However, most macroeconomists predicted there would be strong economic growth numbers at the beginning of the recovery followed by weaker numbers in 2010. Why? As companies reduce inventories more slowly or increase inventories at the end of a recession, GDP grows quickly. Once changes in inventories stabilize, they stop adding to economic growth. That doesn't make sense? Don't worry, we'll examine it further in the section covering GDP. The key point is that having a more complete understanding of economics helps people to have a more accurate view of the economy.

What's coming up in this course?

We are going to begin with exploring the basic ways of measuring the behavior of the overall economy - economic growth, inflation, and the job market. Next, we'll develop a systematic approach to understanding how the economy behaves over time as well as what drives the economy in the near term. Once we develop an overall framework for understanding the economy, we will add a few more pieces - interest rates, budget deficits and the national debt, and monetary policy. In the second half of the semester, we'll begin with a discussion about the behavior of markets followed by exchange rates and elasticity before concluding the course with how the changing economic environment has and will affect the way people do business.

It's an exciting time to study economics, unlike any other in our lifetime. I look forward to our time together exploring today's economy!