

ARTS&SCI 2E03 – Economics: Principles and Policy (2015-16, Term 1)

Professor: William Scarth, KTH-436 x23807 (scarth@mcmaster.ca)

Office hours: Tuesday 10:00-11:30am, Thursday 10:30-11:30am, or by appointment

Class Times: Wednesday 3:30-5:20, BSB/137 and Thursday 8:30-10:20, KTH/B124

TAs: Miranda Carlson-Strain carlsomd@mcmaster.ca, Spencer Williams willisd2@mcmaster.ca, Elliott Yee yeeek@mcmaster.ca. TAs will have office hours that complement the instructor's hours (on other days of the week).

Organization and Evaluation

This course introduces the core principles of economics to Arts & Science students. This reasoning is applied to issues that are central to modern societies: the role of government in a market-oriented setting; equity and efficiency; stabilization policy; unemployment, income distribution, and growth and the environment. The course is divided into three sections, with a test following each section. Each test will contain 5 questions pertaining to that third of the course, with students choosing any four. Each test will count 20% of the overall course grade. The tests take place on: Wednesday **October 7**, Wednesday **November 11** and during the December examination period. The first two tests will occur in the standard class time (but in a testing centre to be identified later). Except for a brief true-false quiz (described below), the "final exam" covers just the third section of the course and has the same format as the other two tests. There are three mini "essays" (10 marks each). The remaining 10 marks for the course derive from the final brief quiz that reviews key insights (10 true-false propositions; 5 marks) and a presentation to a small group of other students and the instructor (your favourite essay topic): 5 marks for the presentation and general participation.

The mini essays involve 1000-1200 words each, and the details regarding content are explained below. Essays are to be handed in at class on Thursday **October 1**, Thursday **November 5** and Wednesday **December 2**. Essays submitted late (by one class) will be marked – with the recorded grade being reduced by two marks (out of the possible ten marks)). Beyond that late date, all ten marks will be forfeited – unless the student has arranged for permission. In that case, the essay is due by the final class in the term, and there will be no penalty. If you have to miss a test, complete the administrative "paperwork" and arrange a make-up test date with the instructor as soon as possible.

Reading

The text is W. Scarth, *Economics: The Essentials, Third Edition*. This book is available free (one *pdf* files for each chapter) by clicking the link on the instructor's web-site: <http://www.economics.mcmaster.ca/faculty/scarth/> A few hard copies are also available for purchase from Rebecca. The pages that are relevant for each week are outlined in the detailed term schedule below. At several points in the course, additional lecture notes will be distributed (as brief *pdf* files attached to the class e-mail distribution list). A report written by the instructor is also included in the course outline. These items represent additional "required reading."

In addition, when preparing for the mini essays, students are expected to consult numerous other sources such as: government policy papers, journals (such as *The Economists' Voice*), studies issued by various "think tanks" (eg – CD Howe, Institute for Research on Public Policy (*Policy Options*), Fraser Institute, Centre for Policy Alternatives), and books. One option for the essays is to evaluate (using the analysis learned in the course) a recent article in a newspaper or magazine (such as *Maclean's* or *The Economist*). Another is to write a book review.

If you choose to write a commentary on an article, you should plan on assigning roughly the first third of your essay to informing the reader of the content of the article. The remainder would be your evaluation of the reasoning – using the analysis you have learned in the course. The purpose is twofold: to let you develop your understanding of economic analysis in precisely those areas that interest you most (in this inquiry third of the course), and to give you experience in making the link between course material and policy issues – an ability you will want to nourish long after the course is over. In previous years, essays have ranged over a host of interesting topics. For example last year's essays included the following topics: obesity and the fat tax, Lego, TOMS shoes, piracy in Somalia, Costco's free samples, salary caps in sports, the music industry, nudges, organ donations, and the one-child policy. Also, several books were evaluated from an economics perspective; eg: the *Bible*, Dr. Suess stories.

Some examples of more traditional books that are suitable for book reviews (or a specific chapter review) are: Krugman *Stop This Recession Now*; Coyle, *The Economics of Enough*; Turner, *Economics After the Crisis*; Posner, *A Failure of Capitalism*; Cohen, *The Wealth of the World and the Poverty of Nations*; Collier, *The Plundered Planet*; Jevons, *Murder at the Margin*; Cassidy, *How Markets Fail: The Logic of Economic Calamities*; Levitt and Dubner, *SuperFreakonomics*; Frank, *The Economic Naturalist's Field Guide: Common Sense Principles for Troubled Times*; Frank *The Darwin Economy*; Stiglitz, *The Price of Inequality*; Cowen, *Discover Your Inner Economist*; Dasgupta, *Economics: A Brief Insight*; Wheelan, *Naked Economics: Undressing the Dismal Science*; Kahneman, *Thinking Fast and Slow*; Thaler and Sunstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness*; Heilbroner, *The Worldly Philosophers: The Lives and Ideas of the Great Economic Thinkers*; Landsberg, *The Armchair Economist*; Ferguson, *The Ascent of Money*; Chang, *23 Things They Don't Tell You About Capitalism*; Heath, *Filthy Lucre: Economics for People Who Hate Capitalism*. Book reviews involve more reading, but you can focus on just a particular chapter in your essay if desired. In any event, ask the instructor about the suitability of other books or if you wish to borrow one of the suggested books.

A final source of topic ideas and economic commentaries is the web. Here are just three possibilities. The CBC has had a series on "the invisible hand": <http://www.cbc.ca/theinvisiblehand/index.html> National Public Radio in the US regularly consults with the authors of *Freakonomics*: <http://www.freakonomics.com/> and Greg Mankiw, a Harvard professor (who is my co-author for another text), has an excellent blog: <http://gregmankiw.blogspot.ca/>

Classes, Tutorials and Student Presentations

Since we are scheduled to meet for 4 hours each week, we have 48 class-room hours, to be used as follows: 32 lectures, 12 tutorials and 4 hours for tests. The tutorials will be the second hour of the Thursday class time each week. Each tutorial will be used to discuss practice questions (to be distributed in advance via the class e-mail list). Many of these questions will be taken from the tests that students wrote in the last couple of years, and the others will be selected from the practice questions contained in the text. Student presentations will take place in small groups meeting together in the instructor's office. Times (near the end of term) will be arranged after term starts.

Detailed Course Outline

Section 1 – Some Pros and Cons of a Market-Oriented Economy

Tools of the Trade: Supply and Demand (chaps 1, 2; Sept 9, 10)
 Rationality and Optimization (chaps 3, 4; Sept 16, 17)
 Market Success: Competition and Comparative Advantage (chaps 5, 10; Sept 23, 24)
 Market Failure: Monopoly and Externalities (chaps 6, 8; Sept 30, Oct 1)

Section 2 – The Distribution and the Growth of Incomes

Structural Unemployment (chap 20 (279-282) + additional notes; Oct 8)
 Poverty and Globalization (chaps 9 (110-14), 18 (253-257) + additional notes; Oct 21, 22)
 Living Standards and Limits to Growth (chaps 19 (259-66, 270-1), 20 (286) + additional notes; Oct 28, 29)
 Tax Reform (chaps 9 (114-22), 19 (266-70) + additional notes; Nov 4, 5)

Section 3 – Cyclical Unemployment, Inflation, Government Debt and Instability

Business Cycles: the Self-Correction Mechanism vs. Stabilization Policy (chap 11; Nov 12)
 Budget Deficits and Government Debt (chaps 12 (170-1), 13 (180-85)
 + http://www.cdhowe.org/pdf/Commentary_412.pdf; Nov 18, 19)
 Fiscal and Monetary Policy (chap 17 + additional notes; Nov 25, 26)
 The International Monetary System (chaps 15 (206-12), 18 (244-253); Dec 2, 3)

Learning Objectives – after each set of lectures you should understand:

Some Pros and Cons of a Market-Oriented Economy

Tools of the Trade: Supply and Demand

- how we use supply and demand curves to understand positive and normative issues such as why price regulations can accentuate scarcity and why the true incidence of a tax depends on the price elasticities of supply and demand, not on the legal incidence of the tax

Rationality and Optimization

- how the household optimal-purchase rule and firms' optimal-hiring rule allow us to appreciate that the area under demand and supply curves represent total satisfaction and total cost, and that opportunity costs are, while sunk costs are not, important in forward-looking decisions

Market Success: Competition and Comparative Advantage

- why a competitive economy supports Adam Smith's "invisible hand" proposition (that selfishness can guide decentralized individuals and firms to replicate the outcome that would be chosen by an all-knowing benevolent social planner) and how we can assess the efficiency and equity aspects of free trade

Market Failure: Monopoly and Externalities

- how the invisible hand reassurance breaks down when some individuals have market power and when private property rights are not well-defined, and how both the equity and efficiency aspects of these monopoly and pollution problems can be addressed by taxes, regulations and tradeable emission permits

The Distribution and the Growth of Incomes

Structural Unemployment

- why asymmetric information between firms and employees concerning worker productivity can generate involuntary unemployment, and how (using our knowledge that the area under an input's demand curve represents total output) we can assess payroll taxes and EI as strategies for coping with unemployment

Poverty and Globalization

- how globalization complicates the government's ability to address poverty, and how several policies (EI, guaranteed annual income, working income tax benefit, employment subsidies for firms) can be evaluated

Living Standards and Limits to Growth

- why there is short-term pain - but long-term gain - involved when we either save more, or use up non-renewable resources at a slower rate, and how we can use discounting to assess the terms of the trade-off between our material living standards and the future of the planet

Tax Reform

- why we have a "welfare wall," whether "trickle-down" economics can be supported, why a progressive expenditure tax is preferred to Piketty's wealth-tax suggestion, and why Canada's Eco-Fiscal Commission has many useful suggestions for raising both equity and efficiency

Cyclical Unemployment, Inflation, Government Debt and Instability

Business Cycles: the Self-Correction Mechanism vs. Stabilization Policy

- why the economy's self-correction mechanism is sometimes unreliable (as stressed by Keynes and as has been the case recently), why measured unemployment fluctuates less dramatically than the GDP, and why even fully anticipated inflation (when interacting with a non-indexed tax system) lowers growth

Budget Deficits and Government Debt

- how varying the budget deficit over the cycle may help stabilize the economy as long as the interest-rate and exchange-rate "crowding-out" effects are small, and why periods of austerity (debt-reduction) are sometimes needed to avoid instability and to maintain our ability to make transfers across generations in the future

Fiscal and Monetary Policy

- which policy - monetary (Bank of Canada) or fiscal (Minister of Finance) - works under which exchange-rate regime, why inflation is the primary concern of the Bank of Canada, and why the Bank is limited when interest rates are near zero (as they are today)

The International Monetary System

- why financial instabilities and crises of confidence concerning particular currencies occur and why moral-hazard considerations complicate the design of policies intended to protect people from these events

Additional Student Responsibilities:

Academic Integrity

You are expected to exhibit honesty and use ethical behaviour in all aspects of the learning process. Academic credentials you earn are rooted in principles of honesty and academic integrity. Academic dishonesty is to knowingly act or fail to act in a way that results or could result in unearned academic credit or advantage. This behaviour can result in serious consequences—e.g., the grade of zero on an assignment, loss of credit with a notation on the transcript (notation reads: “Grade of F assigned for academic dishonesty”), and/or suspension or expulsion from the university. It is your responsibility to understand what constitutes academic dishonesty. For information on the various types of academic dishonesty, please refer to the Academic Integrity Policy, located at:

<http://www.mcmaster.ca/academicintegrity>

The following illustrates only three forms of academic dishonesty:

- 1) Plagiarism—e.g., the submission of work that is not one’s own or for which other credit has been obtained.
- 2) Improper collaboration in group work.
- 3) Copying or using unauthorized aids in tests and examinations.

McMaster Student Absence Form (MSAF)

In the event of an absence for medical or other reasons, students should review and follow the Academic Regulation in the Undergraduate Calendar “Requests for Relief for Missed Academic Term Work.” Please also see the MSAF statement on our website (<http://artsci.mcmaster.ca/forms-requests/>) and direct any questions or concerns to Shelley Anderson or Rebecca Bishop in the Arts & Science Program Office as appropriate.

e-mail contact and Student Responsibility Statement

The instructor and university reserve the right to modify elements of the course during the term. The university may change the dates and deadlines for any or all courses in extreme circumstances. If either type of modification becomes necessary, reasonable notice and communication with the students will be given with explanation and the opportunity to comment on changes. It is the responsibility of students to check their McMaster email and course websites weekly during the term and to note any changes. In this course, the instructor will make announcements in class and by using the course e-mail distribution list.

Academic Accommodation of Students with Disabilities

Students who require academic accommodation must contact Student Accessibility Services (SAS) to make arrangements with a Program Coordinator. Academic accommodations must be arranged for each term of study. Student Accessibility Services can be contacted by phone 905-525-9140 ext. 28652 or email sas@mcmaster.ca. For further information, consult McMaster University’s Policy for Academic Accommodation of Students with Disabilities.

Sustainable Written Work Submission Guideline

The written work submission guidelines have been chosen to support the more sustainable use of paper, energy, and toner, and meet the Gold standard of the Office of Sustainability www.mcmaster.ca/sustainability. Effort should be made for all written work to be submitted in the following format: double-sided printing; no title page; sans-serif font.