Simon Johnson: One Page Summary

15.015, class #1: The Issues, Short-term and Long-term

This course is primarily focused on single country macroeconomic analysis. Most of our discussion will deal with short-run issues (i.e., looking out about 2-3 years).

In *15.223 Global Markets* we'll deal more with multi-country interactions, putting macroeconomics in the context of how the global economic and political system operates – and adding trade and other considerations.

In the first few classes, we will develop some simple analytical tools that will allow us to ask three questions. The remainder of the course will apply these tools to various historical and current situations.

1. What's the (macroeconomic) problem?

We'll use the BBNN framework as a way to diagnose whether an economy has the right balance (a) internally (meaning with regard to unemployment and inflation) and (b) externally (i.e., in terms of a sustainable current account position).

2. What can be done?

We'll use the ISLM framework to examine how monetary and fiscal policy can be used to "move" the economy – either expanding or contracting it.

3. What could go wrong? Two problems need more emphasis than they get in the basic BBNN and ISLM frameworks – keep in mind that those simple models are intended to guide your intuition, not to provide a complete, definitive or dynamic picture.

    a. Government deficits can become unsustainable.

    b. The financial sector (including banks) can expand credit too fast; it can also collapse under some circumstances.

Throughout the course, we'll follow GDP developments and discuss policies in terms of their impact on components of aggregate demand:

$C + I + G = Y$ (output), for a closed economy

Where C is consumption, I is investment, and G is government spending on goods and services (and you should look carefully at the precise definitions of each in the HBS note)

$C + I + G + (X-M) = Y$, for an open economy

Be careful with these equations. Macroeconomists use them as accounting identities, i.e., adding up these components of "final demand" to estimate the level of GDP in any time period. But in many instances we are also interested in behavioral statements, e.g., if we lower tax rates, will that increase consumption; or what would happen if business confidence collapses?

Also, we will repeatedly use a rearranged version of this equation to think about the idea that:

- Local investment = local savings MINUS any government budget deficit PLUS capital that flows in from abroad

Don't worry about the math. Focus on the idea that total savings (domestic + foreign) available in an economy fund both productive investment (I) and any government budget deficit.

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