

Contents

Preface	xiii
Acknowledgments	xvii
CHAPTER 1	
Dynamic Decision Making	1
Problems Change—Why Not Solutions?	3
Developing a Dynamic Decision-Making Process	7
Discussion Questions	19
Notes	21
CHAPTER 2	
Measuring Economic Benchmarks	23
Benchmarking Growth	24
Components of the GDP	27
Benchmarking Inflation: Pricing Power and the Cost of Goods Sold	36
Interest Rates: Real Nominal, the Short and Long End of It All	41
Exchange Rates: A Relative Price with Many Relatives	45
Profits	48
Unbiased Information: Biased Users	50
Discussion Questions	51
Notes	52
Recommended Reading for Serious Players	53
CHAPTER 3	
Cyclical and Structural Change	55
Forces of Economic Success	55
Cyclical Patterns, Linear Projections	57
Leading, Coincident, and Lagging Economic Indicators	59
Identifying Trends and Cycles	64
Bias in Decision Making	66
Cycles, Structural Change, and the Evolution of a Framework	73
	vii

Discussion Questions	78
Notes	79
Recommended Reading for Serious Players	80
CHAPTER 4	
Economic Dynamism: Growth and Overcoming the Limits of Geography	81
A Framework for Growth	83
Population Growth and the Westward Expansion of the United States	88
Institutions and the Savings/Investment Decision	90
Why Does Capital Not Flow to Poor Countries?	92
Overcoming Geography: Stretching the Production Possibilities Curve	92
The Competitive Implications of Altering the Exchange Rate	95
Growth, Opportunity, and Preservation	96
Discussion Questions	97
Notes	99
Recommended Reading for Serious Players	99
CHAPTER 5	
Information: Competitive Edge in the Twenty-First Century	101
Information in an Existing Business	102
Information as an Input to Today's Competitive Advantage	103
Information in a New Growth Business	104
Information as Input to the Decision Process for Firms and Households	106
Three Steps of Information Processing for Decision Makers	107
Information in the Decision Maker's Framework	116
Information as Part of the Business Model	117
Choices and Information Choke Points	119
Discussion Questions	119
Notes	121
Recommended Reading for Serious Players	122
CHAPTER 6	
Risk Modeling and Assessment	123
Economics and the Risk Modeling Process	124
Housing Prices: Deflation and the Shock to the American Psyche	129
Managing Economic Risk within the Decision-Making Process	132
Assessing Risks Using Econometric Models	138
Identifying Change	141

Contents

ix

Principles for a New Model	153
Discussion Questions	155
Notes	157
Recommended Reading for Serious Players	158
CHAPTER 7	
Money, Interest Rates, and Financial Markets	159
Markets before Institutions	162
Markets: Interdependence and the Driving Force of Unexpected Events	162
Change and Putting Our Framework through Its Paces	166
Short-Run to Long-Run Adjustment	170
Quality Spreads, the Economic Cycle, and Accounting for Risk	172
Evolution of the Money, Inflation, and Interest Rate Framework	173
Lessons for Decision Makers	175
Discussion Questions	176
Notes	177
Recommended Reading for Serious Players	178
CHAPTER 8	
Strategy, Risk, Uncertainty, and the Role of Information	179
Four Levels of Strategic Thinking	180
Discussion Questions	197
Notes	198
Recommended Reading for Serious Players	198
CHAPTER 9	
Capital Markets: Financing Operations and Growth	199
Engine of Analysis: The Market for Real Capital and the Market for Funds	200
Perspective of Change over Time	201
Economic Change as Driver of an Evolving Capital Market Framework	203
Complex Interactions: Economics, Expectations, and Information	205
The 1980s: Another Decade, Another New Normal for the Financial Markets, and the Critical Role of the Recency Bias	208
Internal Cyclical Changes in Capital Markets and the Overconfidence Bias	210

Two Underappreciated Forces in Financial Markets Are Irony and Paradox	211
The Great Recession of 2007 to 2010: Under the Heading That Facts Don't Matter until They Do	212
Economic Evolution and the Changing Risk/ Reward Calculation	213
Price Dichotomy: Traded and Non-Traded Goods	215
Introducing the Wake-Up Call	216
Precise Mathematics Gives Way to Imprecise Reality: What Happens to Markets When the Average Expected Return and the Variability of Returns Become Uncertain?	217
Choices: Reacting to Feedback—The Most Dangerous Phase of the Credit Cycle	221
Credit Crunches: When Markets Don't Clear	224
Capital Markets and the Life Cycle of an Institution	226
Capital Markets and the Allocation of Capital	230
Discussion Questions	232
Notes	233
Recommended Reading for Serious Players	235
CHAPTER 10	
Financial Ratios: The Intersection of Economics and Finance	237
Financial Ratios	237
Developing a Framework within a Broader Economic Setting	240
Financial Ratios as Information	248
Discussion Questions	267
Notes	268
Recommended Reading for Serious Players	270
CHAPTER 11	
Fiscal Policy as Agent of Change	271
Fiscal Policy over Time: Altering Incentives and Rewards of Risk Taking	272
Public Policy and Private Expectations—the Lucas Critique	284
Interdependence between Fiscal and Monetary Policy	285
Policy in the Context of Expectations and Information	289
Long-Run Equilibrium versus Short-Run Equilibrium	292
When the Long-Run Outlook Impacts Today's Behavior	294
Political Business Cycle: Political Realities for Private Decision Makers	296
Fiscal Policy in an Open Economy: The United States in the Twenty-First Century	298

<i>Contents</i>	xi
Discussion Questions	298
Notes	300
Recommended Reading for Serious Players	301
CHAPTER 12	
Global Capital Flows: Financing Growth, Creating Risk and Opportunity	303
Building a Framework for Understanding	304
A Model of Capital Flows to Frame Our Decisions	306
The American Framework in Global Capital Markets: The Evolution of Imbalances	313
Global Interest Rates	320
Risks and Opportunities: Not All Countries Fit One Mold	323
Implications for Decision Makers: Introducing Risk into the Global Capital Markets	328
Feedback, Altered Expectations, and Building the New Framework	330
A New Framework and the Overconfidence Bias	332
Discussion Questions	332
Notes	333
Recommended Reading for Serious Players	334
CHAPTER 13	
Innovation and Its Role in Economics and Decision Making	335
Innovation and the Economy	336
Innovation and the Patterns of Progress	349
Risk, Innovation, and Prospect Theory	352
Innovation, Economic Thought, and the Big Challenges of the Day	354
Discussion Questions	357
Notes	358
Recommended Reading for Serious Players	359
APPENDIX	
The Hodrick-Prescott Filter	361
Autoregressive Conditional Heteroscedasticity (ARCH)	365
About the Author	369
What's on the Companion Web Site	370
Index	371

<http://www.pbookshop.com>