

Economics 1: Fall 2010

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cast of thousands...

http://delong.typepad.com/econ_1_fall_2010/

Ladies and Gentlemen, to Your i>Clickers...

- How many people think the just-past block of “depression economics” lectures went...
 - A. Too fast?
 - B. Too slowly?
 - C. Just right?

Economics 1: Fall 2010: Inflation Economics

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Inflation Economics

- $Y = (M/P) \cdot V$
- And let us say $Y = Y^*$, the economy is at full employment
 - Or near full employment: there is some wiggle room
 - overtime, extra vacancies, etc....
- $Y^* = (M/P) \cdot V$
- $P = (M \cdot V)/Y^*$
- So what happens when something boosts M or V?
 - P goes up

The Phillips Curve

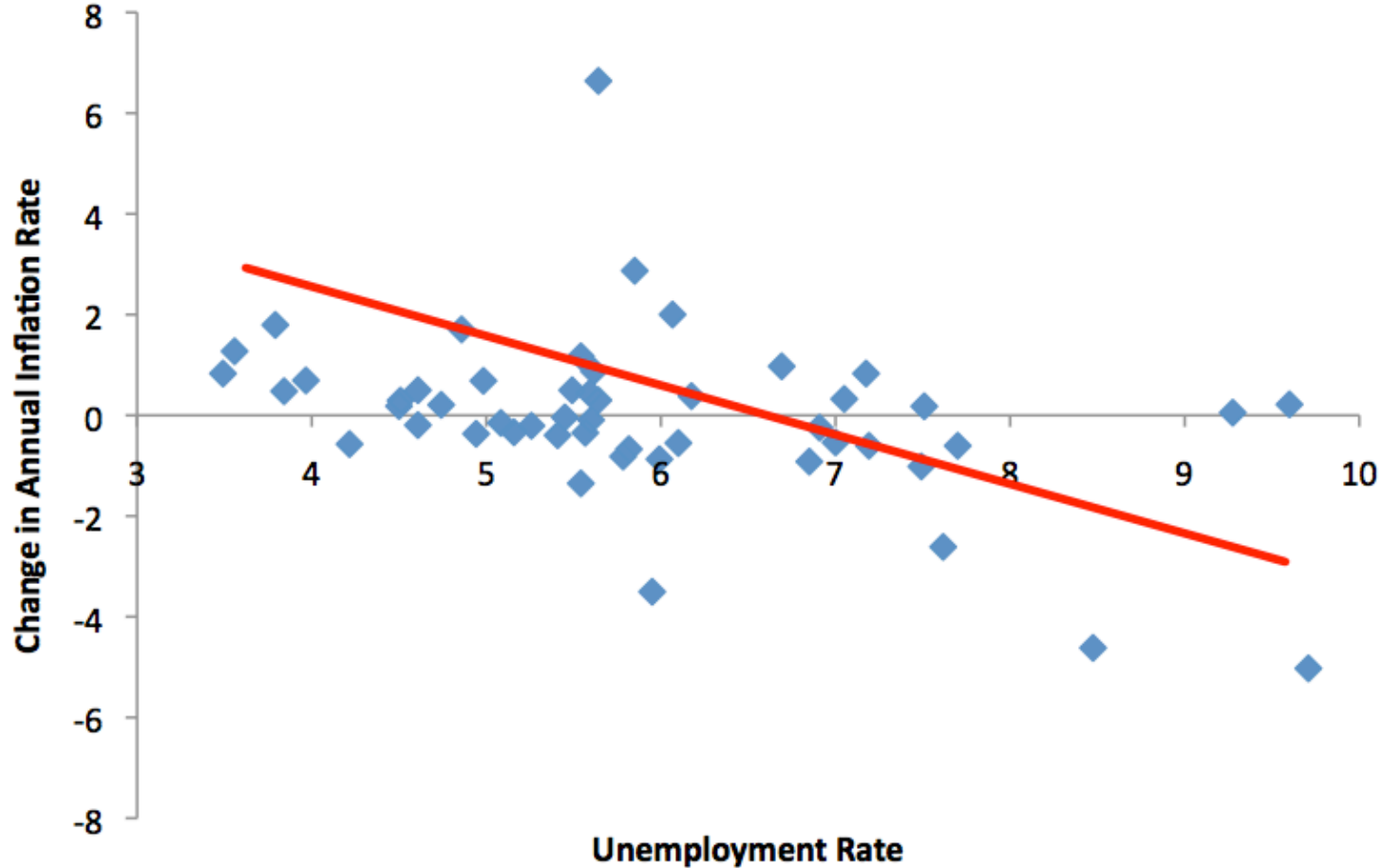
- π : inflation
- $(P(t)-P(t-1))/P(t-1) = \pi(t)$
- $E(\pi)$: expected inflation:
- u : unemployment rate
- u^* : the “natural” rate of unemployment, the NAIRU
- $\pi = E(\pi) + \beta(u^* - u)$

The Phillips Curve II

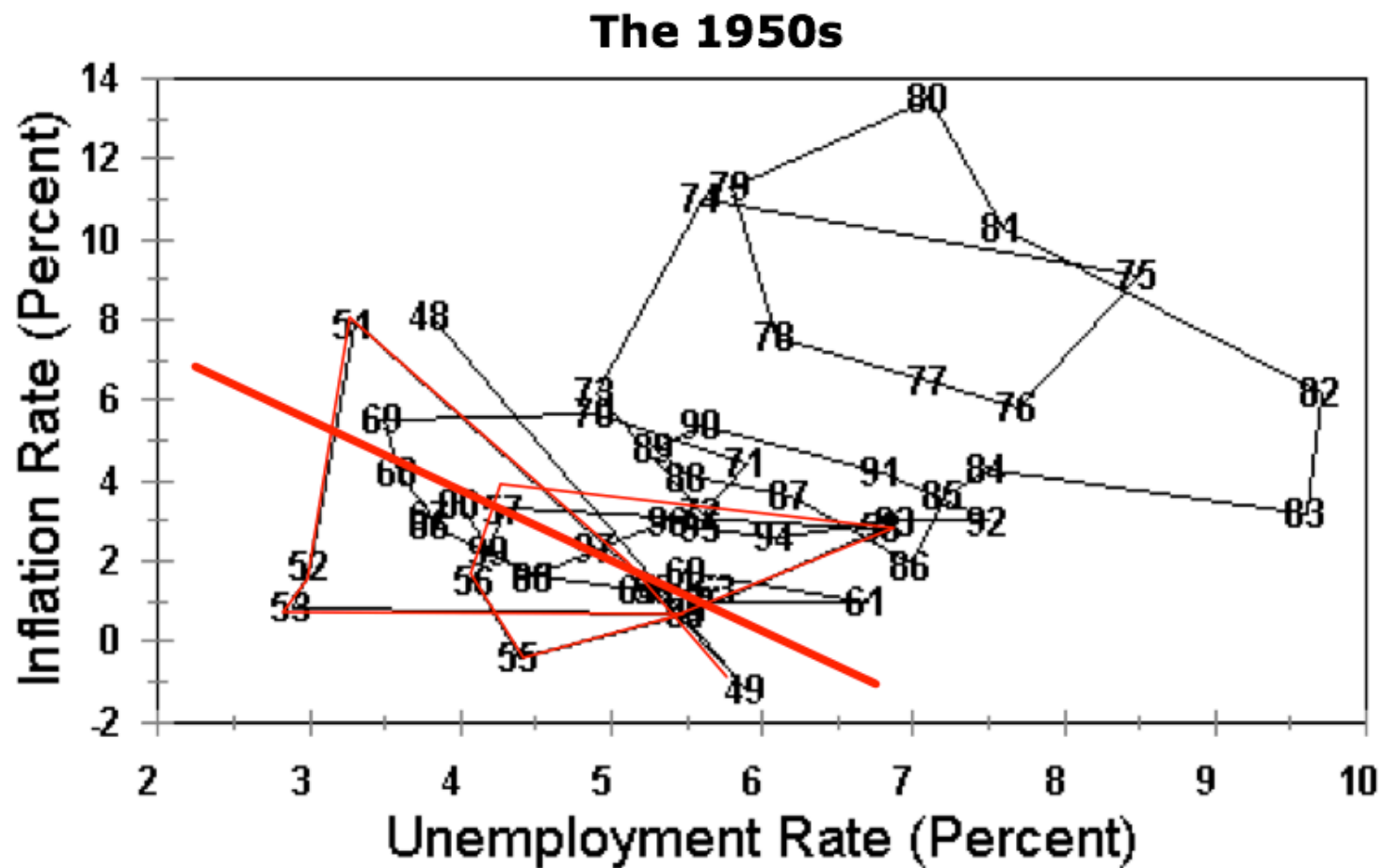
- $\pi = E(\pi) + \beta(u^* - u)$
- Usually u^* will be stable (say, 5% in the U.S. today)
 - Sometimes not: varieties of “structural” unemployment
- Usually $E(\pi)$ this year will pretty much be just what inflation was last year
 - Sometimes not
 - President Mitterand of France at the start of the 1980s

The Unemployment Rate and the Change in Inflation

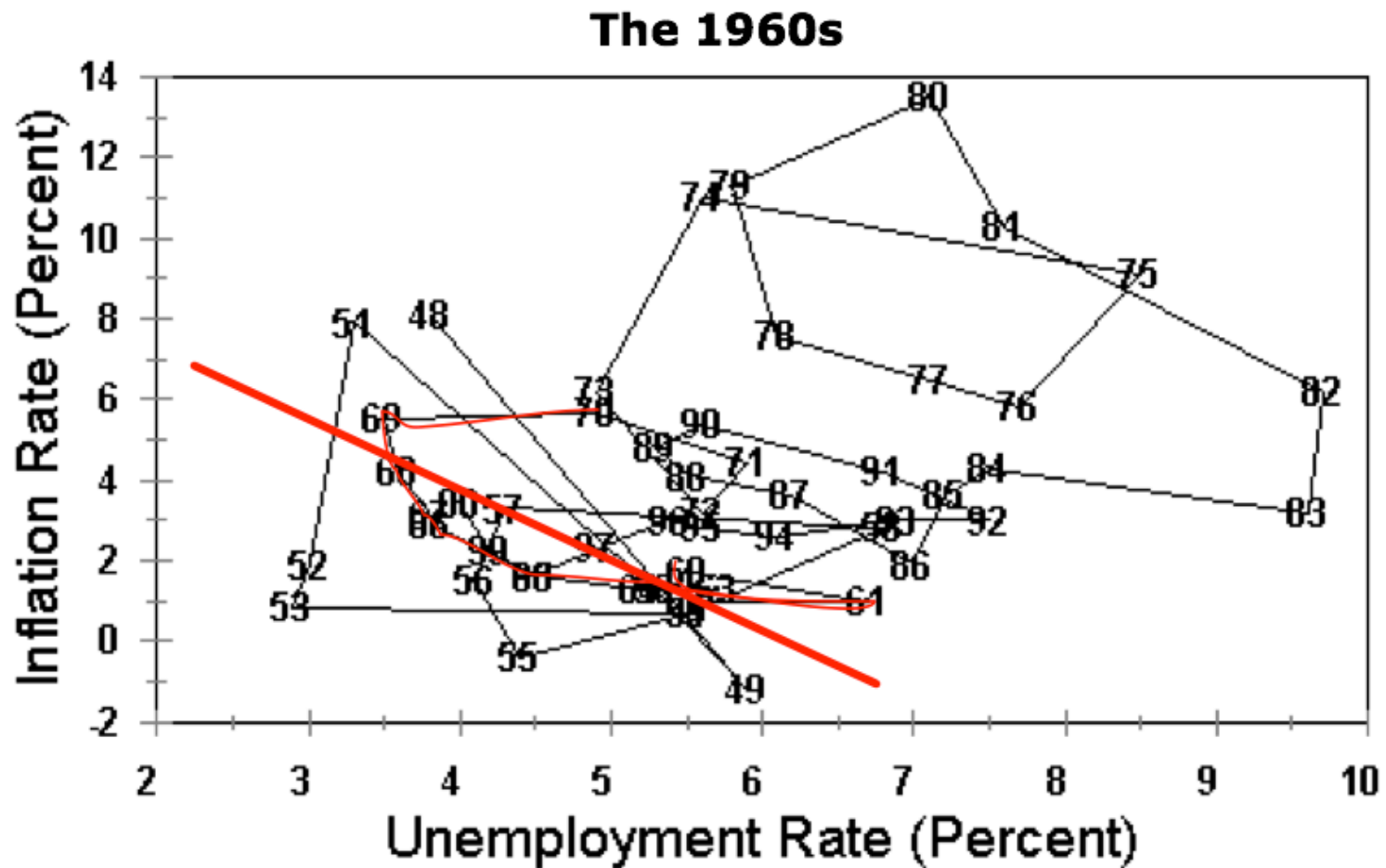
Change in Inflation, 1959-2009



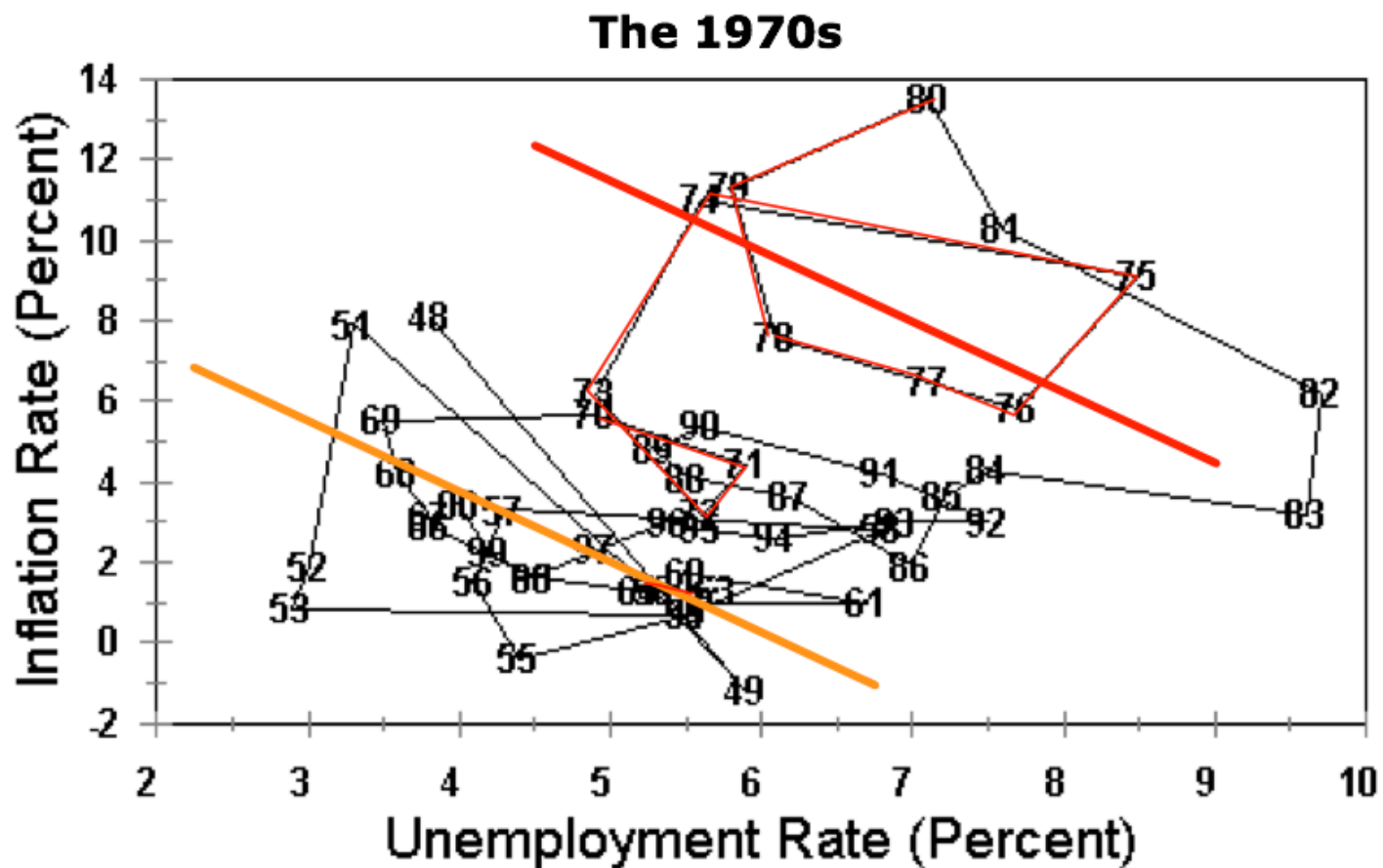
The Phillips Curve: The 1950s



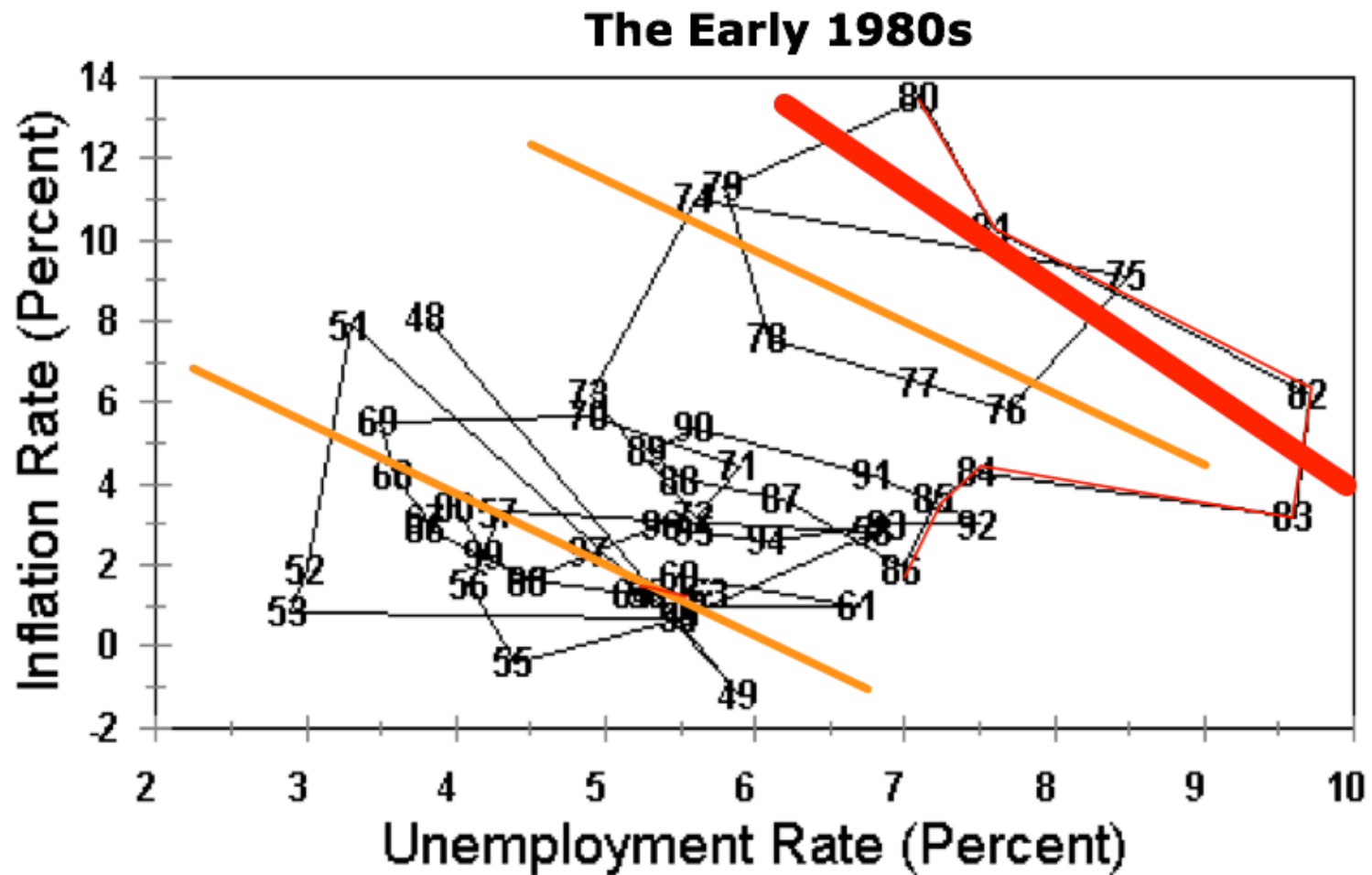
The Phillips Curve: The 1960s



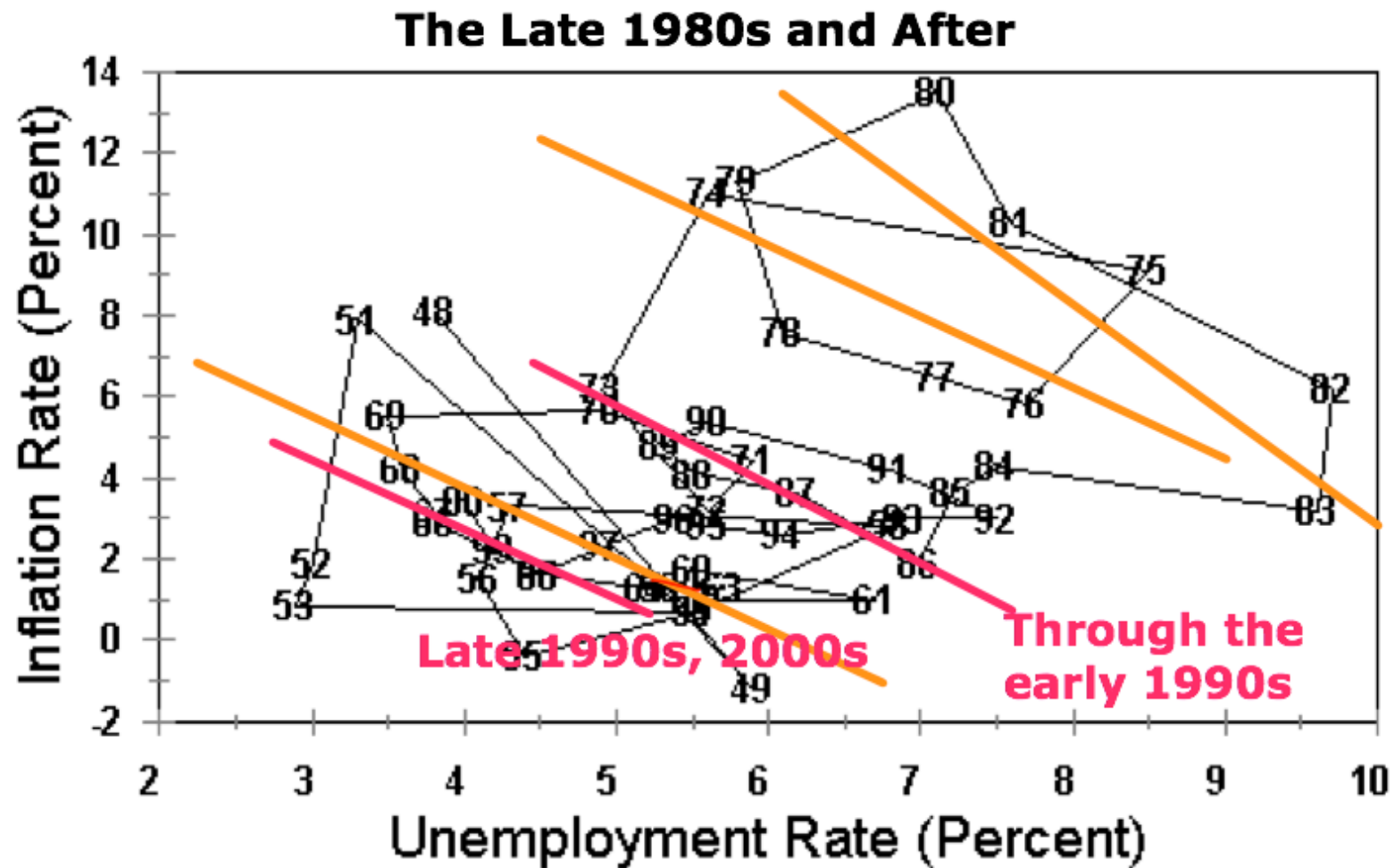
The Phillips Curve: The 1970s



The Phillips Curve: The Early 1980s



The Phillips Curve: From the Late 1980s



Ladies and Gentlemen, to Your i>Clickers...

- The Phillips Curve Is:
 - A. One of the most armor-plated, reliable, stable findings in all empirical economics
 - B. Too uncertain to be relied on
 - C. Tells you little about what will happen to inflation next year—hence ignorable
 - D. Tells you a lot about what will happen if unemployment stays high (or low) for even half a decade—hence essential
 - E. About to be tested: will the U.S. see actual deflation as it has never seen it since the Great Depression itself?

Why Does It Matter?

- Should we care about inflation?
- I mean, if wages and prices rise at about the same amount, why is it a problem?
- Why would anybody ever do what Paul Volcker did in 1982—deliberately trigger a nasty episode of depression economics in order to push inflation down?

Ladies and Gentlemen, to Your i>Clickers...

- Which Star Trek movie grossed the most, controlling for inflation?
 - A. Star Trek: The Motion Picture
 - B. Star Trek (2009)
 - C. Galaxy Quest
 - D. Star Trek II: The Wrath of Kahn
 - E. Star Trek IV: Star Trek at the Monterey Aquarium

The Numbers

- STTMP: \$82
- STWK: \$79
- STSP: \$76
- STVH: \$110
- STFF: \$52
- STUC: \$75
- STG: \$76
- STFC: \$92
- STI: \$70
- STN: \$43
- ST (Reboot): \$258

The Inflation-Adjusted Numbers

- STTMP: \$262
- STWK: \$181
- STSP: \$163
- STVH: \$217
- STFF: \$93
- STUC: \$121
- STG: \$112
- STFC: \$129
- STI: \$93
- STN: \$52
- ST (Reboot): \$258

Inflation Deranges the Price System

- A market economy works by people using prices to calculate what to do
- And a market economy works well when prices reflect actual social values and scarcities
 - That is, when low-priced things are “cheap” in the sense that they use up little of our resources; and high-priced things are “valuable” and hence worth making
- Inflation makes these calculations difficult, and error-ridden

Inflation Is Unjust

- John Maynard Keynes:
 - Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some.
 - The sight of this arbitrary rearrangement of riches strikes not only at security, but at confidence in the equity of the existing distribution of wealth. Those to whom the system brings windfalls, beyond their deserts and even beyond their expectations or desires, become 'profiteers,' who are the object of the hatred of the bourgeoisie, whom the inflationism has impoverished, not less than of the proletariat.
 - As the inflation proceeds and the real value of the currency fluctuates wildly from month to month, all permanent relations between debtors and creditors, which form the ultimate foundation of capitalism, become so utterly disordered as to be almost meaningless; and the process of wealth-getting degenerates into a gamble and a lottery.
 - Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.

Test Your Knowledge

- What happens to the quantity equation $Y = (M/P) \cdot V$ when you are at “full employment”, when $Y = Y^*$?
- Why does the Phillips Curve slope down?
- What is the natural rate of unemployment u^* ?
- How many significant shifts in inflation expectations have there been in the post-WWII U.S.?
- When did they occur?
- Why is inflation worth worrying about?