

Economics 1: Spring 2012

Markets as Win-Win II[?]

J. Bradford DeLong, Lanwei Wang, and a
cast of thousands...

February 8, 2012

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

- Problem Set 2 was
 - A. too short and too easy.
 - B. too long and too hard.
 - C. too short and too hard.
 - D. too long and too hard.
 - E. Just right.

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

- Problem Set 2 was
 - A. too boring.
 - B. too challenging.
 - C. just right.
 - D. not connected enough with the lectures.
 - E. not connected enough with the textbook.

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

- About how much does use of markets rather than command amplify societal economic productivity?
 - A. None
 - B. Doubles it
 - C. Triples it
 - D. Quadruples it
 - E. Quintuples it

How Much Does Market Organization Matter?

East-Block Country	GDP per Capita	Matched West-Block Country	GDP per Capita	Percentage Gap
N. Korea	\$700	S. Korea	\$7,660	91%
China	\$490	Taiwan	\$9,500	95%
Vietnam	\$170	Philippines	\$850	80%
Cambodia	\$150	Thailand	\$2,110	93%
Georgia	\$580	Turkey	\$2,970	80%
Russia	\$2,340	Finland	\$19,300	88%
Bulgaria	\$1,140	Greece	\$7,390	85%
Yugoslavia	\$3,240	Italy	\$19,840	84%
Hungary	\$3,350	Austria	\$23,510	86%
Czech Republic	\$2,710	Germany	\$23,560	88%
Poland	\$2,260	Sweden	\$24,740	91%
Cuba	\$460	Mexico	\$3,610	88%
Geometric Mean:	\$930		\$8,030	88%

My Lords, Ladies, and Gentlemen, to Your iClickers...

- Guest lecturers: Bob (Reich), Laura (Tyson), Christy (Romer), Partha (Dasgupta), Paul (Seabright)
 - A. Bob (F12-2)
 - B. Laura
 - C. Christy (TTh 12:30-2)
 - D. Partha ??
 - E. Paul (April)

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

- Any arrangement that could generate more economic surplus than a competitive market in equilibrium?
 - A. Yes
 - B. No
 - C. Not sure

Markets Are Maximum Win-Win

- Create the most surplus
- Don't leave anybody worse off when you open up a market...
- So why don't we use markets for everything?

So Why Don't We Use Markets for Everything?

- Hidden assumptions:
 - No “general equilibrium” effects

So Why Don't We Use Markets for Everything?

- Hidden assumptions:
 - No “general equilibrium” effects
 - Open a market for yoga lessons, all the home health aides go to work teaching yoga instead, and you don't have the money to hire a home health aide because you are poor...

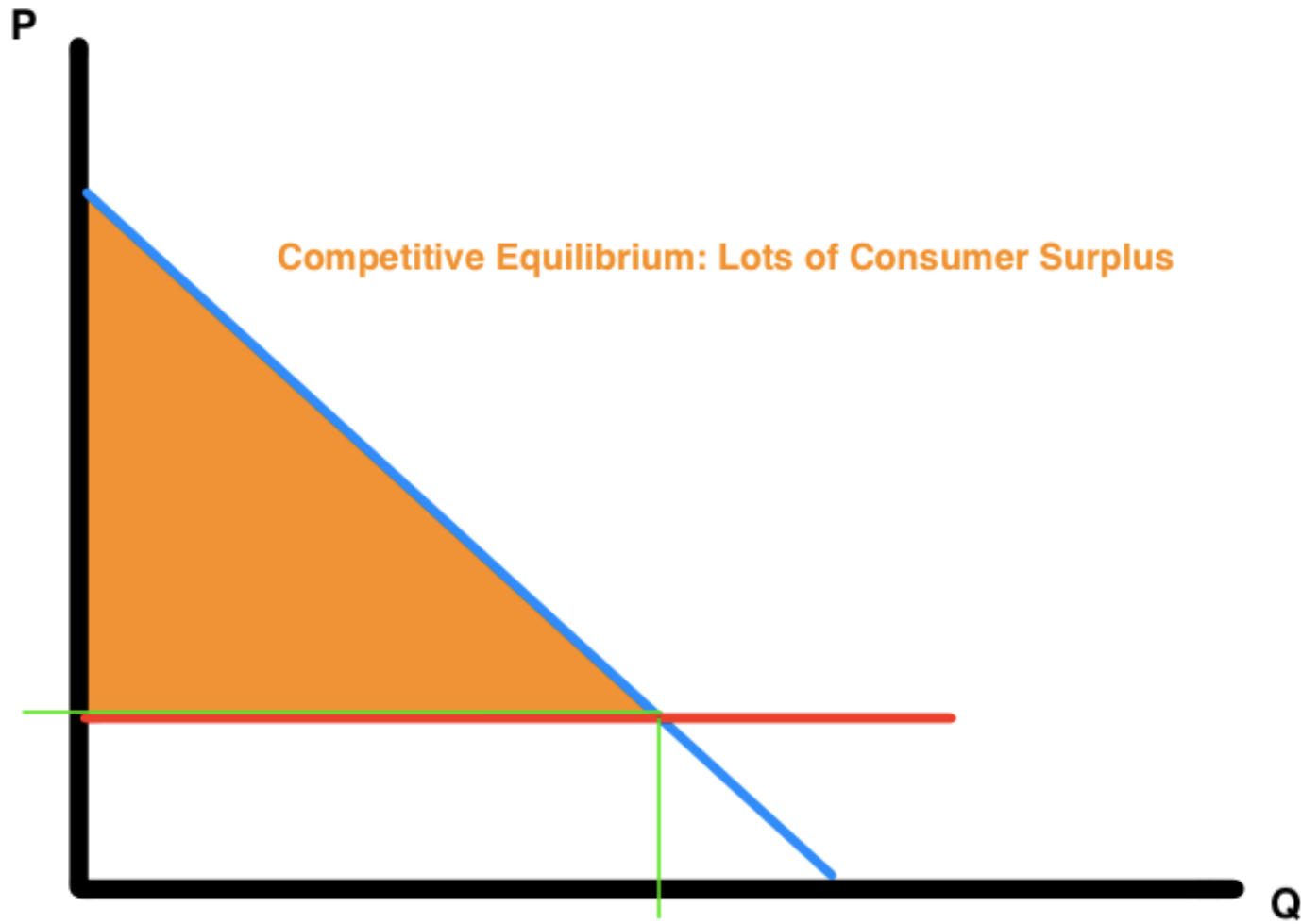
So Why Don't We Use Markets for Everything?

- Hidden assumptions:
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 - Competitive market

So Why Don't We Use Markets for Everything?

- Hidden assumptions:
 - No “general equilibrium” effects
 - Competitive market
 - Market isn't competitive: monopoly or monopsony

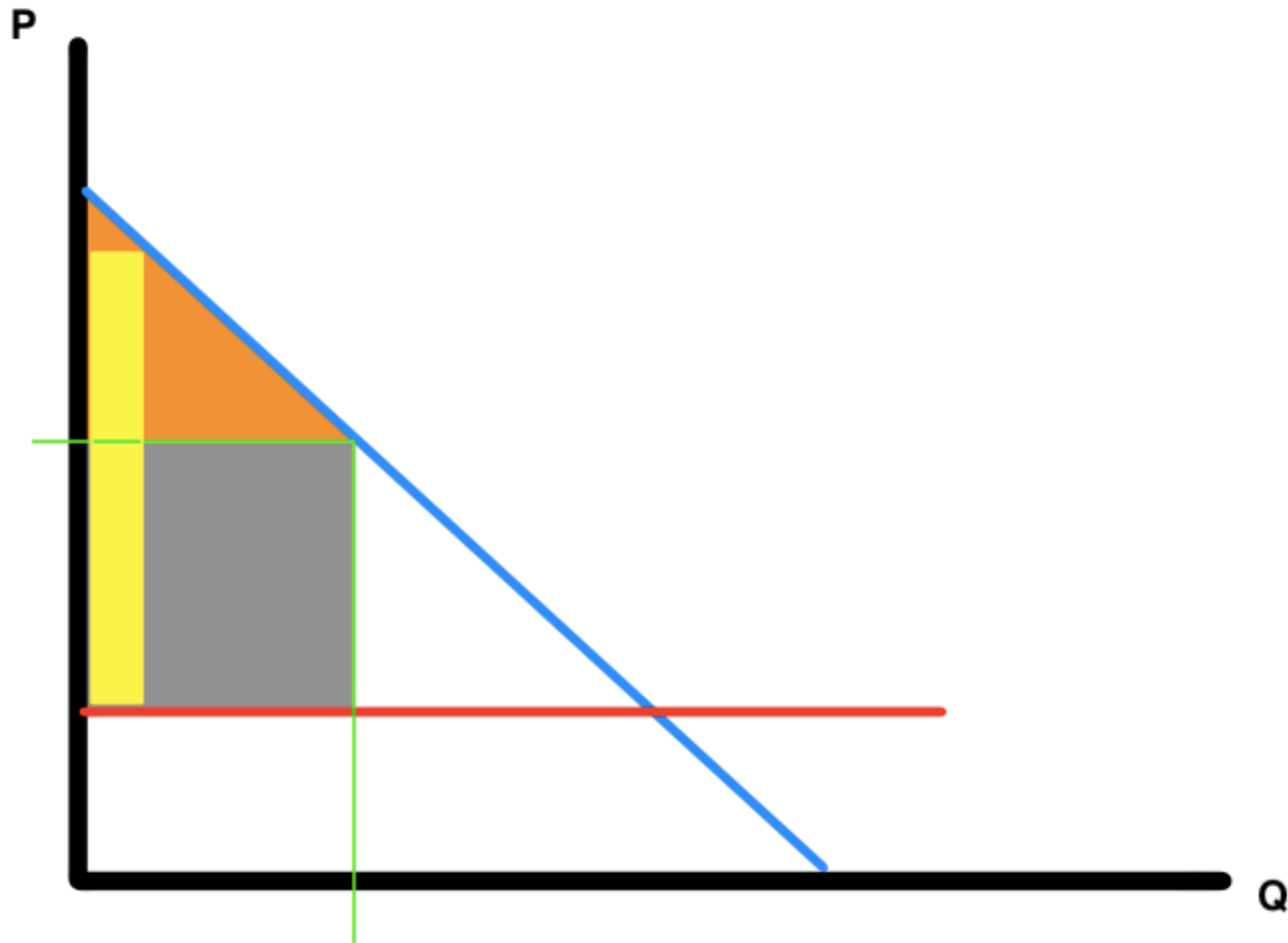
Competition and Monopoly



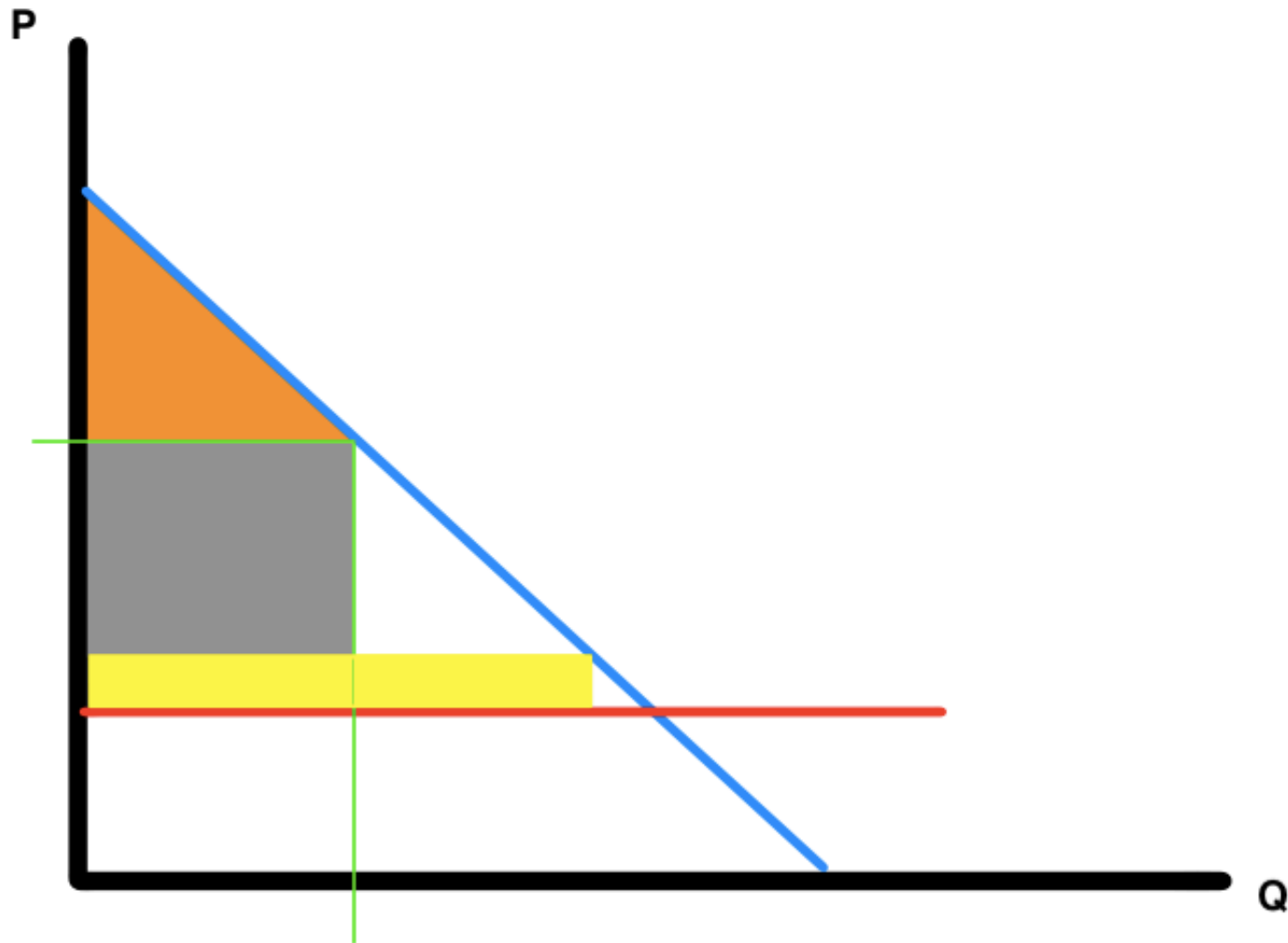
My Lords, Ladies, and Gentlemen, to Your i>Clickers...

- If you have a monopoly, it is likely to:
 - A. Produce as much and charge the same price as a competitive industry
 - B. Produce less and charge the same price as a competitive industry
 - C. Produce more and charge higher prices than a competitive industry
 - D. Produce less and charge higher prices than a competitive industry
 - E. Produce more and charge less than a competitive industry

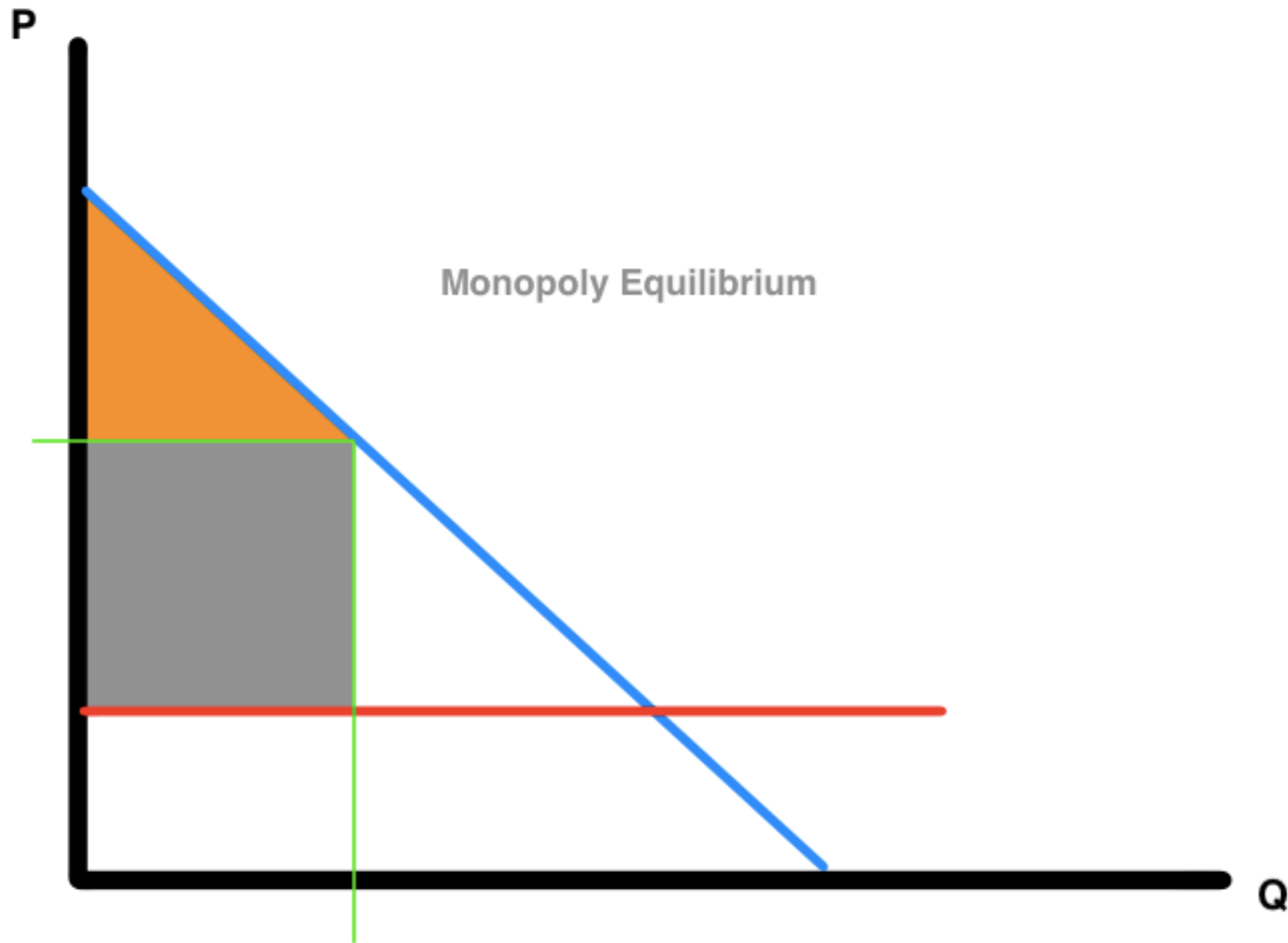
Competition and Monopoly



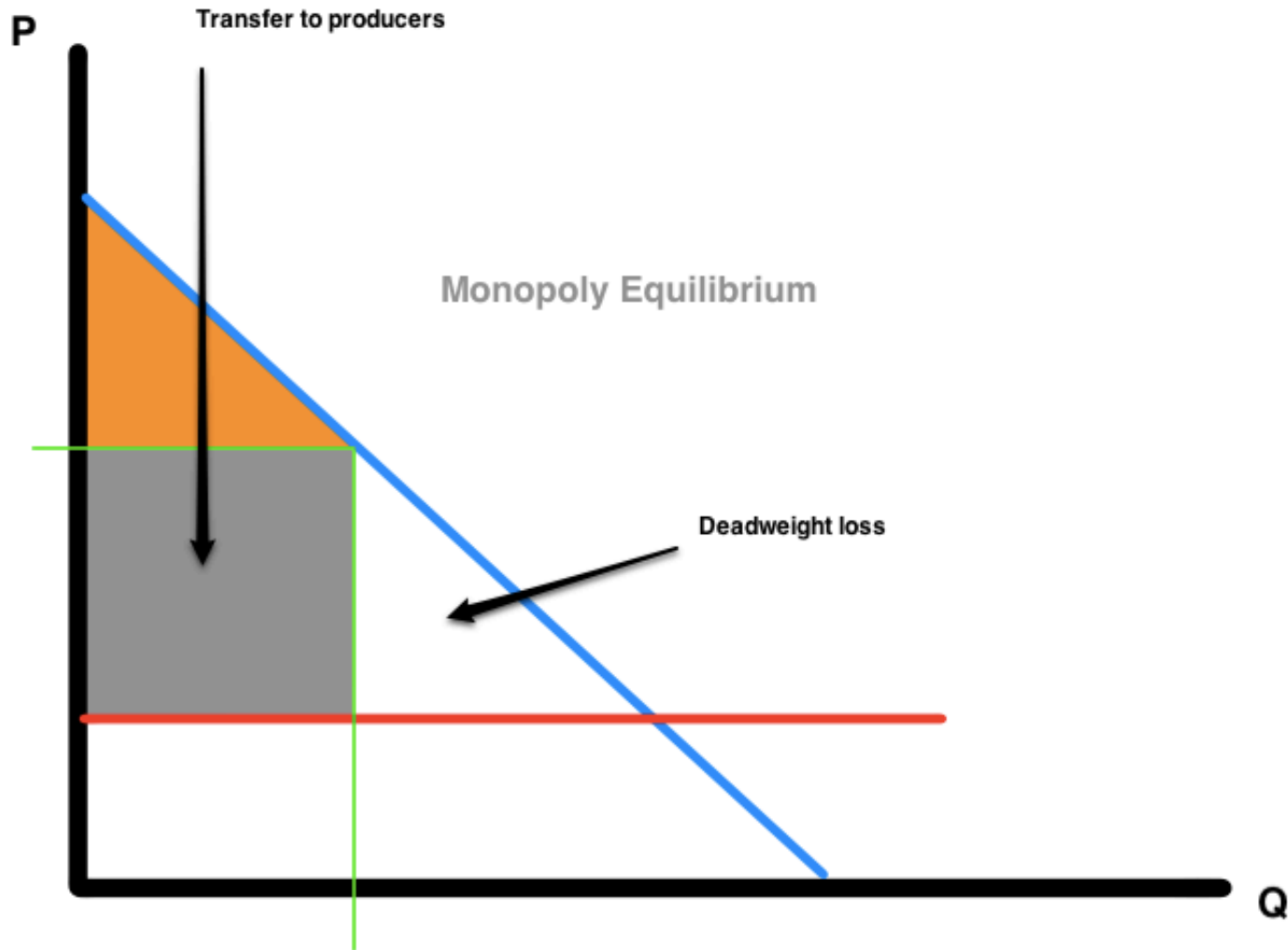
Competition and Monopoly



Competition and Monopoly



Competition and Monopoly



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

- How much does market organization matter?
 - A. Reduces societal productivity
 - B. x 2
 - C. x 3
 - D. x 4
 - E. x 5

How Much Does Market Organization Matter?

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So Why Don't We Use Markets for Everything?

- Hidden assumptions:
 - No “general equilibrium” effects
 - Competitive market
 - Equilibrium market

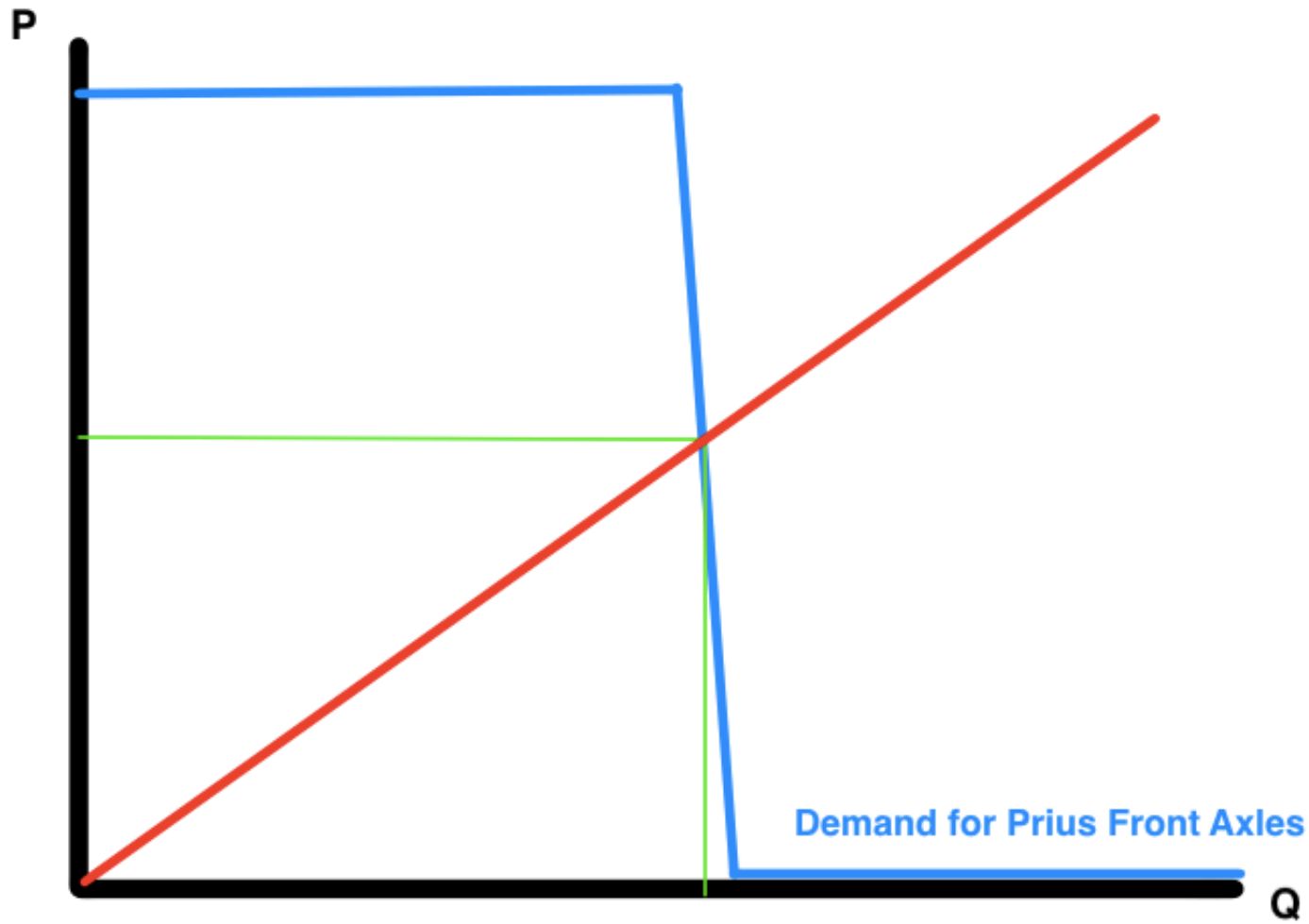
So Why Don't We Use Markets for Everything?

- Hidden assumptions:
 - No “general equilibrium” effects
 - Competitive market
 - Equilibrium market
 - What happens when the market is not in equilibrium?

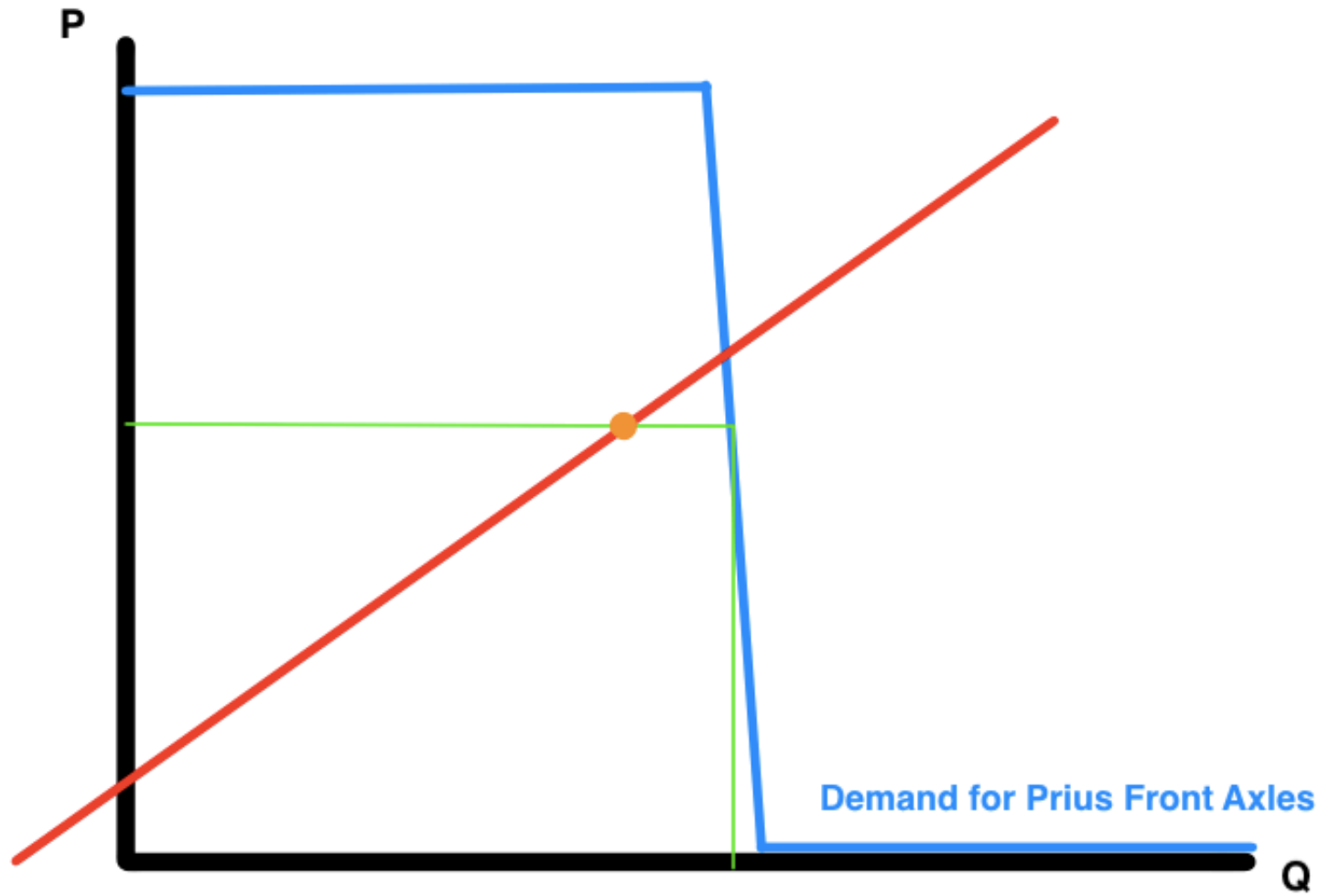
Out of Equilibrium...



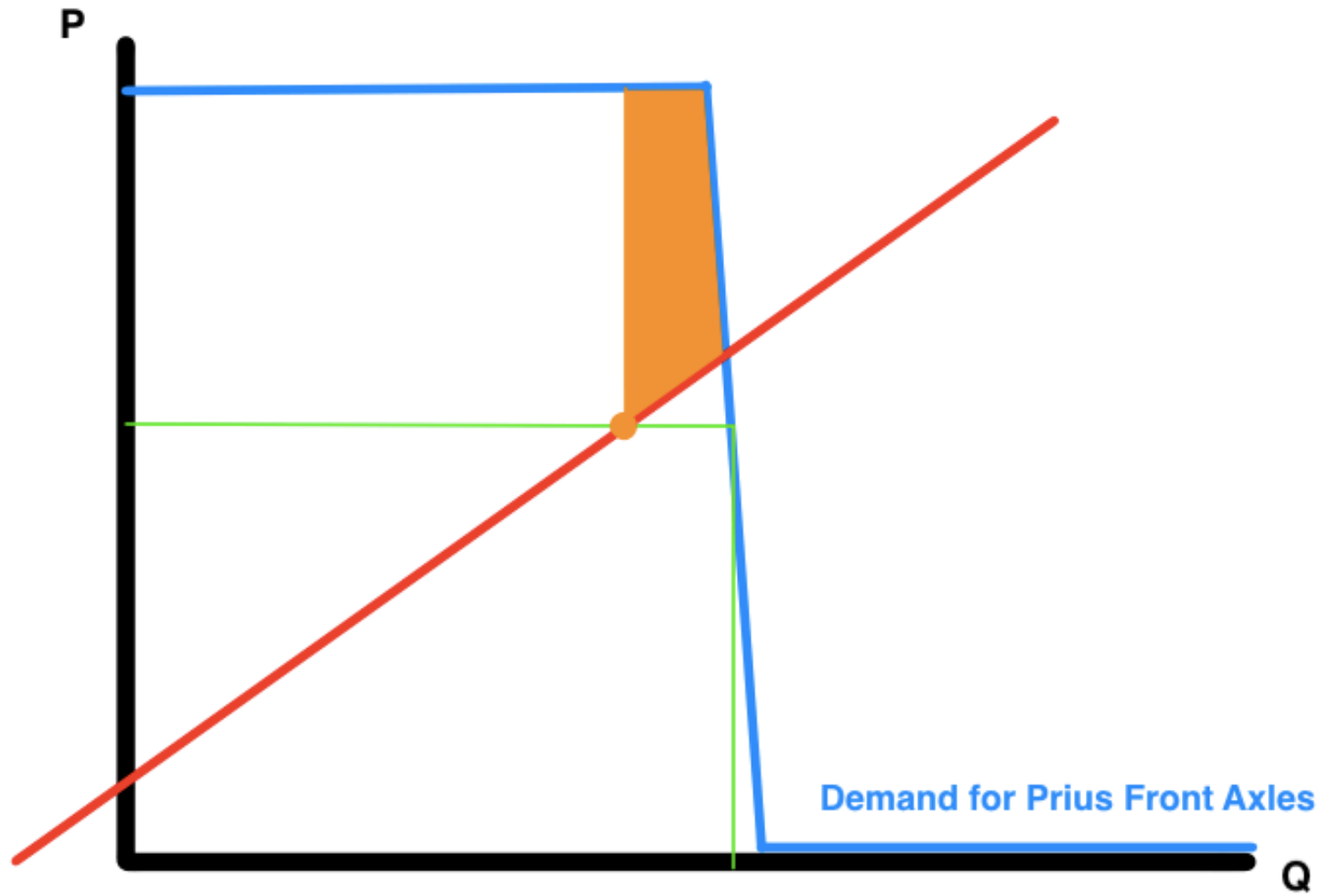
Here's Where the Equilibrium Should Be...



Something Happens to Disturb Supply...



And You Have Made a Horrible Mistake...



The General Lesson: Equilibrium

- Price signals—markets—are subject to large errors where interdependencies are such that you need to get quantities exactly right
 - But a market economy can have large firms
- Quantity signals—central planning—are subject to large errors when the planner does not know in advance what valuations and costs really are
 - And a centrally-planned economy cannot get that information revealed

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

- What is the big reason we don't like monopoly?
 - A. It restricts output, and we lose economic surplus.
 - B. It redistributes a lot of surplus from people in general to rich monopolists.
 - C. It reduces economic surplus by restricting output and by wasting resources on lobbying to create and maintain itself.

So Why Don't We Use Markets for Everything?

- Hidden assumptions we have already covered:
 - No “general equilibrium” effects
 - Competitive market
 - Equilibrium market
- One more hidden assumption:
 - Definition of surplus

Definition of Surplus

- Surplus calculated using money...
- Willingness to pay...
- Reservation wages...

This Definition Can Get Us into Trouble



- \$220K wages and salaries
- \$30K health and insurance benefits
- \$30K retirement benefits
- \$80K outside labor income
- \$60K capital income
- = \$420K Family Economic Income

This Definition Can Get Us into Trouble...



- \$420K/year



- \$1.5K/year

This Definition Can Get Us into Trouble...



- The global market economy gives me 630 votes on what to produce and who should get it—and gives him 1 vote...

Bengal Famine



Bengal Famine



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

- Why did we use a lot more central planning during World War II than we have since?
 - A. In wartime, we don't care about efficiency.
 - B. In wartime, it's more important to get quantities of key products right than to avoid waste by producing some things worth less than their resource costs.
 - C. Because we were stupid: a market economy would have worked better than a centrally-planned one even in wartime.
 - D. Because times of economic turmoil produce lots of lucky windfalls, and it seemed letting those windfalls lie where they fell would be unfair and bad for morale.

What Does the Market Do?

- Maximizes economic surplus measured in commodities valued at their market prices
- Doesn't maximize social welfare
- Doesn't maximize human happiness
- A version of the Golden Rule: he who has the gold makes the rules...

That Said, Desirable Properties of the Market Equilibrium

- It is where the supply and demand curves cross
- Nobody is rationed out of the market
- It is stable
- It produces the maximum dollar-value social surplus
 - No other possible arrangement produces more social surplus
 - Other arrangements have
 - Some of the wrong people teaching the classes
 - Some of the wrong people taking the classes
 - Too few classes being offered
 - Too many classes being offered

Other Arrangements Leave Side Deals

- Potential side deals
 - Some of the wrong people teaching
 - Teachers and non-teachers should swap
 - Some of the wrong people taking
 - Students and non-students should swap
 - Too many people teaching
 - Teachers and students should agree to go home
 - Not enough people teaching
 - Non-teachers and non-students should find a way to offer and attend a class
- A competitive market equilibrium leaves no side deals

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

- But is a competitive market equilibrium fair? Should we impose an excess profits tax on Albus, Tom, Hermione, and Harry, and an excess education fee on yogastudent#1 through yogastudent#10?
 - A. Yes on both the teachers and the students, because it is unfair to the rest of us that they like yoga so much
 - B. Yes on the teachers, because they are getting a job they really, really like, but not on the students because it is not their fault that they like yoga and they should not be penalized.
 - C. Yes on the students, because it is not fair that they get to pay so little for something so valuable to them, but not on the teachers because it is not their fault that they are good at teaching and enjoy what they do and they should not be penalized.
 - D. No on both: we cannot help how we are made, or what we like and dislike.
 - E. What is this “fair”? And once you start taxing people not for what they do but for how they feel, don’t you create a huge problem of deception and lies that you will not be able to untangle? The task here is to figure out what maximizes the total value we create rather than trying fruitlessly to ensure that nobody is enjoying themselves too much.

Non-Market Processes Considerably Worse

- Viceroy Archibald Wavell vs. Winston Churchill...
- Peng Dehuai vs. Mao Zedongt

Not Winston Churchill's Finest Hour...

- In response to an urgent request by the Secretary of State for India, Leo Amery, and Viceroy of India Archibald Wavell, to release food stocks for India, Winston Churchill the Prime Minister of that time responded with a telegram to Wavell asking, if food was so scarce, "why Gandhi hadn't died yet" ...

Non-Market Economies Considerably Worse...

