

# Logistics: IAS 107

J. Bradford DeLong  
U.C. Berkeley  
IAS107 First Lecture Notes

January 18, 2011

# IAS 107 Basics

- **Staff:** J. Bradford DeLong: <<mailto:delong@econ.berkeley.edu>>: 925 708 0467: W 2-4 Evans 601. Dariush Zahedi.
- **Meetings:** Lecture: TuTh 11-12:30 VLSB 2060. Sections: M 2 183 Dwinelle; M 3 251 Dwinelle; W 1 255 Dwinelle; W 4 83 Dwinelle; F 9 106 Wheeler; F 1 247 Dwinelle
- **Materials:** Bethany McLean and Joe Nocera: *All the Devils Are Here*. Portfolio ISBN-10: 1591843634. J.B. DeLong and Martha Olney: *Macroeconomics* (2nd ed.) McGraw-Hill ISBN-10: 0072877588. iClicker ISBN-10: 0716779390. 2010 *Economic Report of the President* <<http://www.whitehouse.gov/administration/eop/cea/economic-report-of-the-President>>
- **Website:** <[http://delong.typepad.com/berkeley\\_econ\\_101b\\_spring](http://delong.typepad.com/berkeley_econ_101b_spring)>
- **Schedule:** Midterms: Tentatively March 10, and April TBA. Final: Th May 12 8-11. Weekly problem sets due Th starting Jan 27.
  - 20% each midterm. 30% final. 20% problem sets. 10% section participation. 10% iClicker extra-credit (non-refundable).
- **Waitlist:**
- **Audience:** Median grade will be a high B- (or a low B if I am really happy with how the class has gone). This is a course for Political Economy majors. This is not a terribly good course for Haas majors.

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

- **Do you have an iClicker?**
  - A. Yes
  - B. No
  - C. Maybe

# IAS 107 Tentative Schedule

- **Intro**
- **Economic Growth**
- **Depression Economics**
- **Inflation Economics**
- **Midterm (tentatively Mar 10)**
- **The Long Run**
- **Starting Mar 31:** perhaps our schedule will have slipped, perhaps we will go back over some in more depth some of our topics, perhaps we will do something else that seems interesting-- the world will be different at the start of April than it looks today...
- **Second Midterm in April**
- **Th Apr 28: Final Review**
- **Th May 12: 8-11: FINAL EXAM**

# IAS 107 Tentative Schedule: Intro

- Tu Jan 18: The Four Branches of Macroeconomics
- (read ch. 1: Introduction to Macroeconomics).
- Th Jan 20: Keeping Track of the Macroeconomy
- (read chs. 2 and 3: Measuring the Macroeconomy and Thinking Like an Economist).

# IAS 107 Tentative Schedule: Economic Growth

- Tu Jan 25: Economic Growth Overview
- (read ch. 4: The Theory of Economic Growth).
- Th Jan 27: The Industrial Revolution, the Demographic Transition, and the Coming of Modern Economic Growth
- (read ch. 5: The Reality of Economic Growth) (problem set 1 due).
- Tu Feb 01: The Macroeconomics of Development: Convergence and Divergence Across Nations.
- Th Feb 03: Spurring the Rate of Technological and Organizational Progress
- (problem set 2 due).

# IAS 107 Tentative Schedule: Depression Economics

- Tu Feb 08: The Great Recession.
- Th Feb 10: The Income-Expenditure Model
- (read chs. 6 and 9: Building Blocks of the Flexible-Price Model and The Income-Expenditure Framework) (problem set 3 due).
- Tu Feb 15: IS, LM, and Interest Rate Spreads
- (read chs. 10 and 11: Investment, Net Exports, and Interest Rates and Extending the Sticky Price Model).
- Th Feb 17: Policies to Fight the Great Recession (problem set 4 due).
- Tu Feb 22: The Great Recession Outside the United States.

# IAS 107 Tentative Schedule: Inflation Economics

- Th Feb 24: Inflation and the Phillips Curve
- (read chs. 8 and 12: Money, Prices, and Inflation and The Phillips Curve and Expectations (problem set 5 due).
- Tu Mar 01: Expected Inflation and the Natural Rate of Unemployment
- Th Mar 3: Monetary Policy Reactions
- (read ch. 13: Stabilization Policy) (problem set 5 due).
- Tu Mar 08: Pre-Midterm Review.
- Th Mar 10: Midterm.



# IAS 107 Tentative Schedule: The Long Run, and After

- Tu Mar 15: From the Short-Run to the Long-Run.
- Th Mar 17: Government Debt Economics: Crowding Out and Crowding In
- (read chs. 7 and 14: Equilibrium in the Flexible Price Model and The Budget Balance, the National Debt, and Investment) (problem set 6 due).
- Tu Mar 29: Four Topics of Macroeconomics Review
- Starting Th Mar 31: Any one of three things might happen.
  - First, perhaps our schedule will have slipped.
  - Second, we can go back over some in more depth some of the topics: economic growth, catch-up and economic development, depression economics, inflation economics, government debt economics, international finance.
  - Third, we could do something else that seems interesting--the world will be different at the start of April than it looks today...
- Th Apr 28: Final Review
- Th May 12: 8-11: FINAL EXAM

# Why Macroeconomics?

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# What Is the Reason for “Macroeconomics”?

- The four parts of macroeconomics: growth, depression, inflation, debt-and-deficit.
- Why “macroeconomics”? Why not simply economics? What ties these four parts of macro together? And what differentiates macro from just plain vanilla economics?
- Plain vanilla economics presumes that the market system as a whole is functioning reasonably well:
  - Almost all sellers find willing buyers and vice versa. Almost all contracts and promises made are kept. Almost all expectations of prices are accurate.
- But what if this overriding assumption is wrong? What if the web of connected markets does not work smoothly? That is why we need macro.
- In all four parts of macroeconomics, something is going wrong with the entire system. Hence you need a macro perspective to analyze it properly.

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

- **How many midterms will we have?**
  - A. Zero
  - B. One
  - C. Two
  - D. Three
  - E. Four

# Growth Economics: The Very Long Run: Looking Backward

Rough World Averages		
Year	Population	Income
-8000	5	\$500
0	170	\$500
1500	500	\$500
1800	750	\$600
1900	1500	\$1200
2007	6300	\$7000

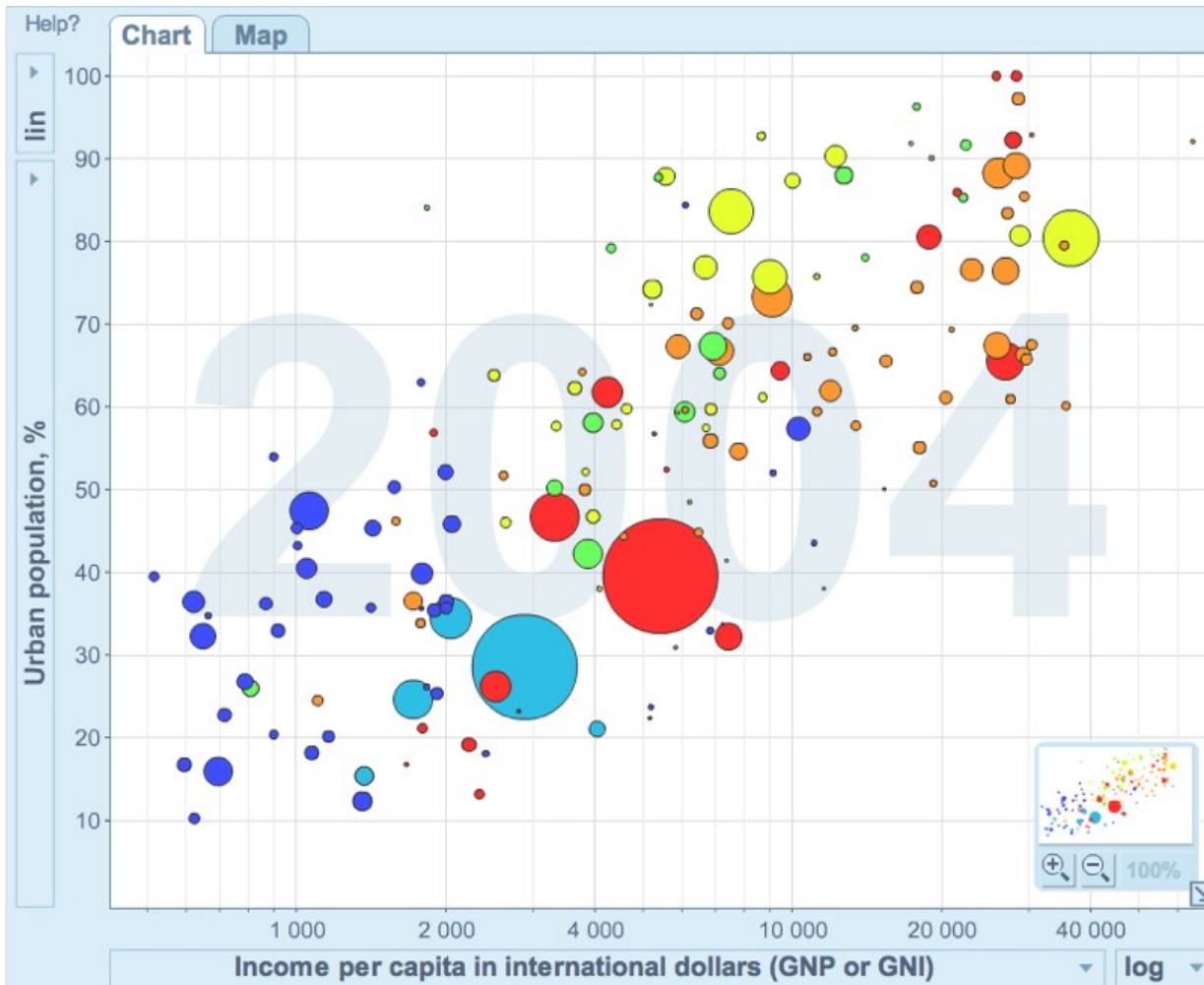
Period	Real GDP Growth	TFP Growth (1)
-8000-0	0.04%	0.01%
0-1500	0.07%	0.02%
1500-1800	0.2%	0.09%
1800-1900	1.38%	0.89%
1900-2007	3.38%	2%

(1) $\alpha=0.3$ ; $\beta=0.2$
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- Halt at 2007—the last business-cycle peak
- 10,000 years since the invention of agriculture
- Population x1200?
- Average income x14?
- Peak regional income x100?
- Two great eras:
  - Malthusian era
  - Modern economic growth

# Growth Economics: The Very Long Run: Looking Sideways



- A more unequal world than ever
- Why this extraordinary divergence?
- It's not that it's hard to go places, or communicate with them...

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

- **What are the four parts of macroeconomics?**
  - A. Keynesian, classical, Marxist, and post-Keynesian
  - B. Keynesian, monetarist, classical, and Marxist
  - C. Depression, inflation, growth, and debt-and-deficit
  - D. Ambition, distraction, uglification, and derision.
  - E. Addition, subtraction, multiplication, and division.

# Depression Economics: Sunday's News

## Irish central bank boosts emergency liquidity

By John Murray Brown

Published: January 16 2011 13:27 | Last updated: January 16 2011 13:27

Ireland's central bank increased its provision of emergency liquidity support to its domestic banking system in December, as the country's financial crisis intensified and bank deposit withdrawals rose.

Irish banks have become increasingly dependent on central bank support to fund their balance sheets, as they lose business and retail deposits and are unable to refinance maturing bank borrowings.

In the wake of the crisis, Irish banks have looked to the European Central Bank for support, but in the past few months as the banks have exhausted the assets such as loan books they have to pledge with the ECB as collateral they have turned to their own central bank, under a programme called **emergency liquidity assistance**, which has to be approved by the ECB's governing council.

Irish Central Bank monthly figures published on Friday show that ELA increased between November 26 and December 31 by €6.4bn from €44.67bn to €51.09bn. However this is less than the €10bn provided in November, and the almost €14bn in October. Analysts believe the use of ELA funds may have peaked around the end of the September, when Irish banks were unable to refinance around €25bn of outstanding bank borrowings maturing with the expiry of the government's two year guarantee, first introduced in September 2008.

Separate figures from the European Central Bank show that Irish banks' use of the ECB's liquidity window declined in December by €4.4bn although total amounts outstanding to Irish banks at December 31 stood at €132bn or 24.1 per cent of total ECB support for the eurosystem of eurozone central banks.

Anglo Irish Bank, the lender at the centre of Ireland's property and banking crash, is believed to be the main recipient of ELA support. According to its latest financial statement, Anglo Irish was reliant on money from banks and central banks for 36 per cent of total funding at the end June 2010. Of the €26.3bn borrowed, €11.6bn was from the Irish Central Bank, under what is called "special master repurchase agreements, which officials say is part of the ELA scheme.

The ELA scheme is understood to involve collateral which would not normally be acceptable to the ECB. In the case of Anglo Irish, the bank pledged the promissory notes provided by the Irish government as part of its recapitalisation of the bank.

### ▼ EDITOR'S CHOICE

**Dublin gives glimpse of secretive funding** - Jan-13

**Analysis: Europe: Star-crossed levers** - Jan-09

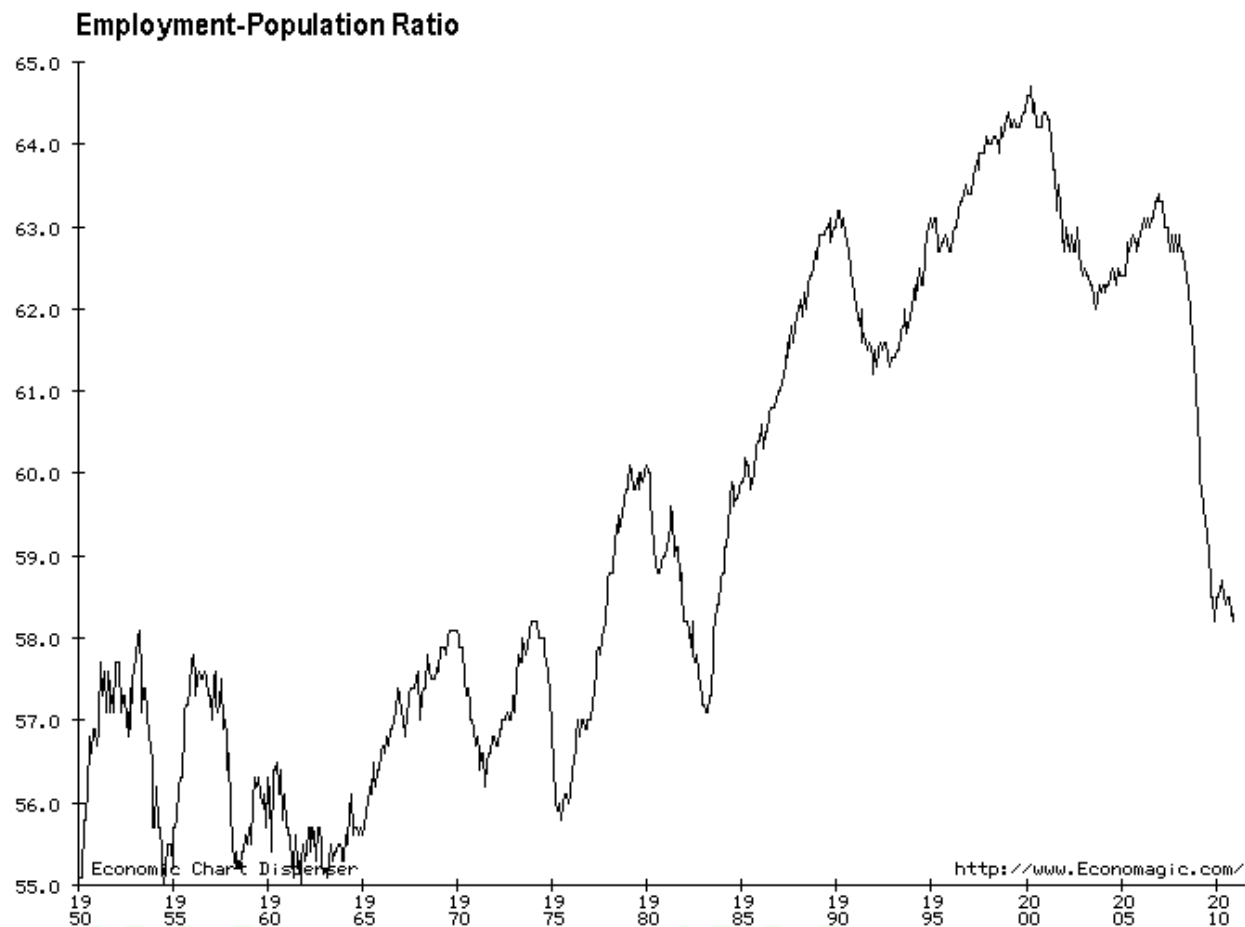
**Trichet urges more action on euro crisis** - Jan-07

**Eurozone unemployment stuck at record levels** - Jan-07

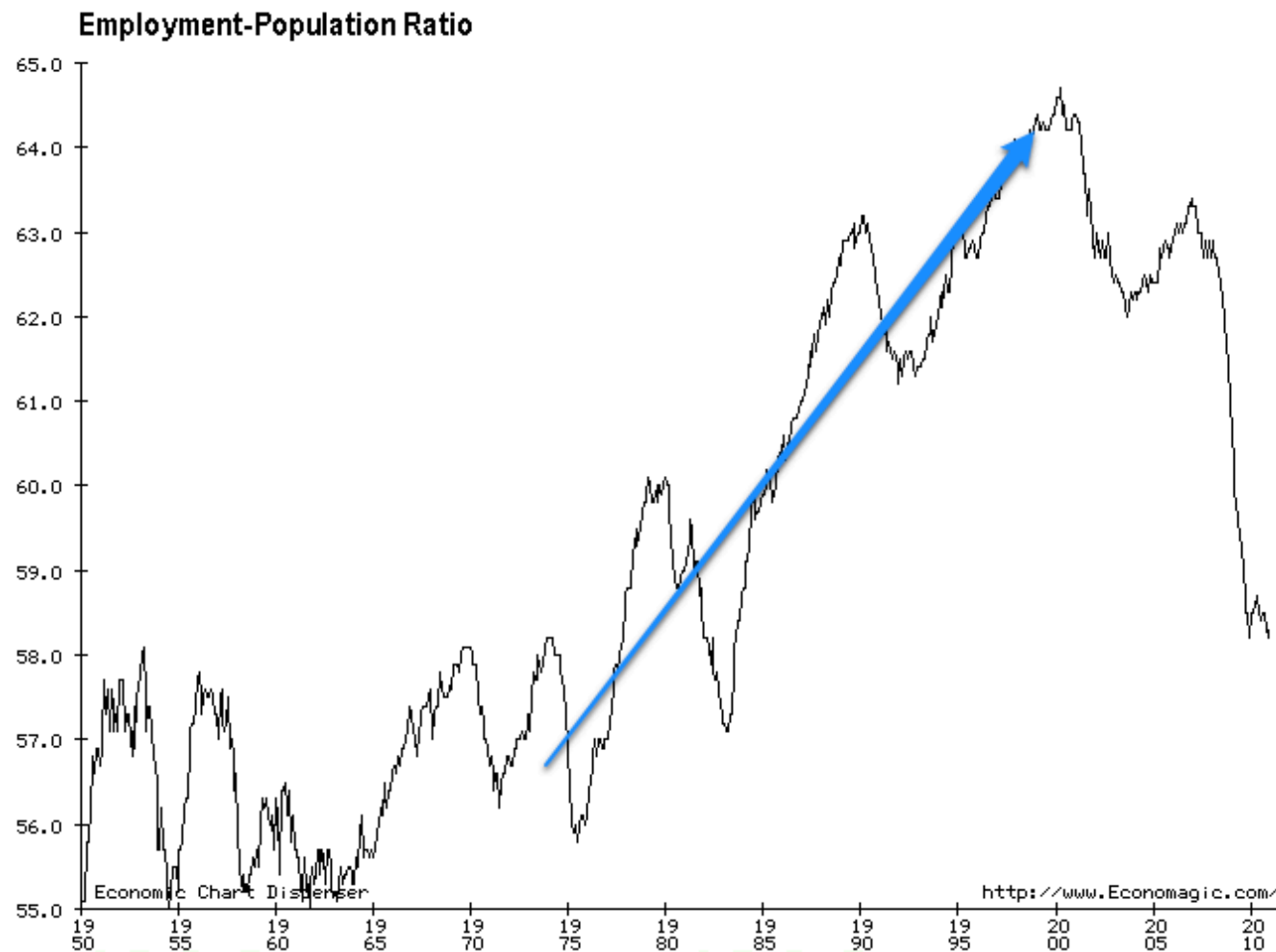
**Irish bank governor aims to reassure markets** - Jan-07

**Belgium in deadlock as talks mediator quits** - Jan-06

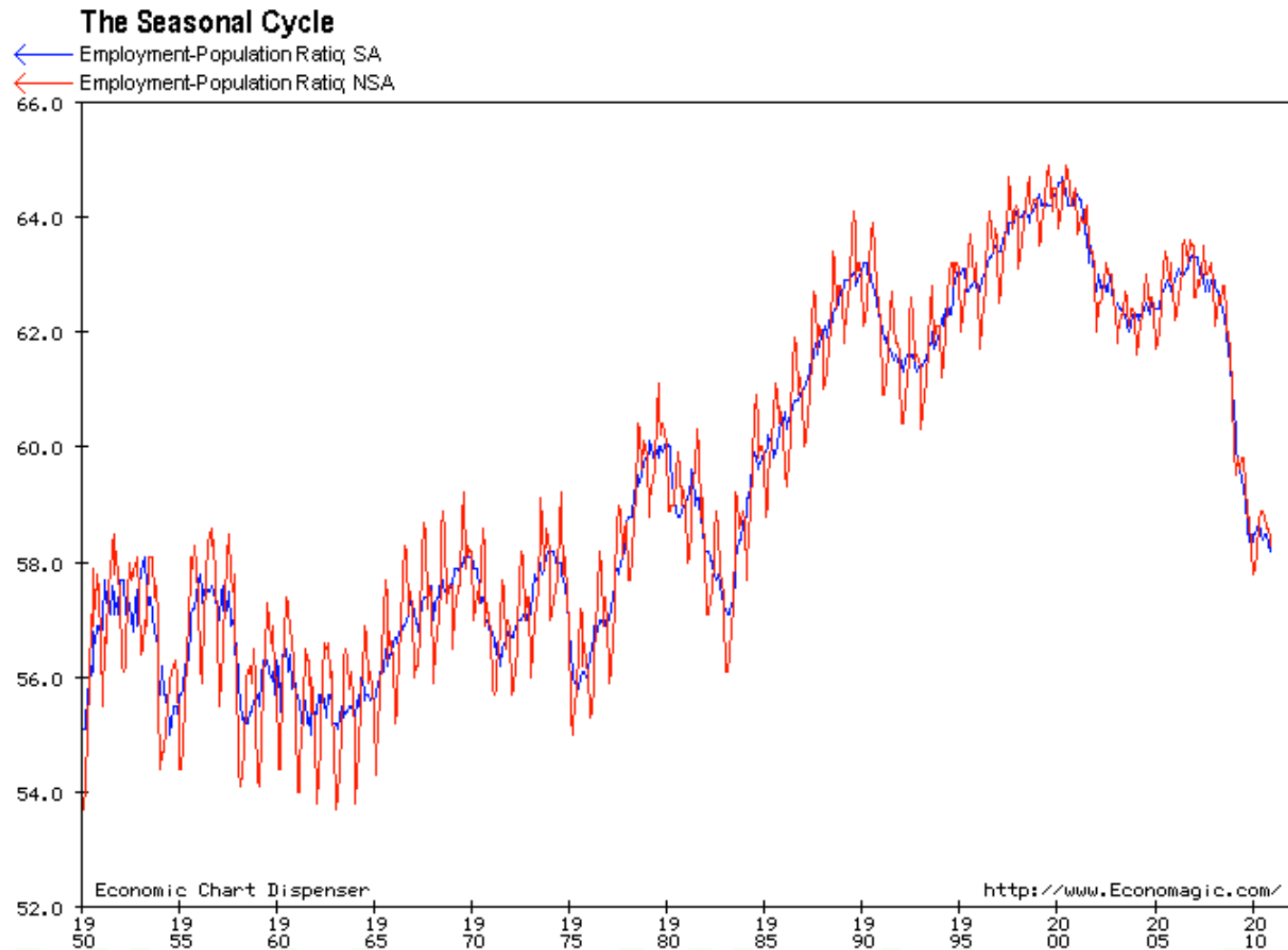




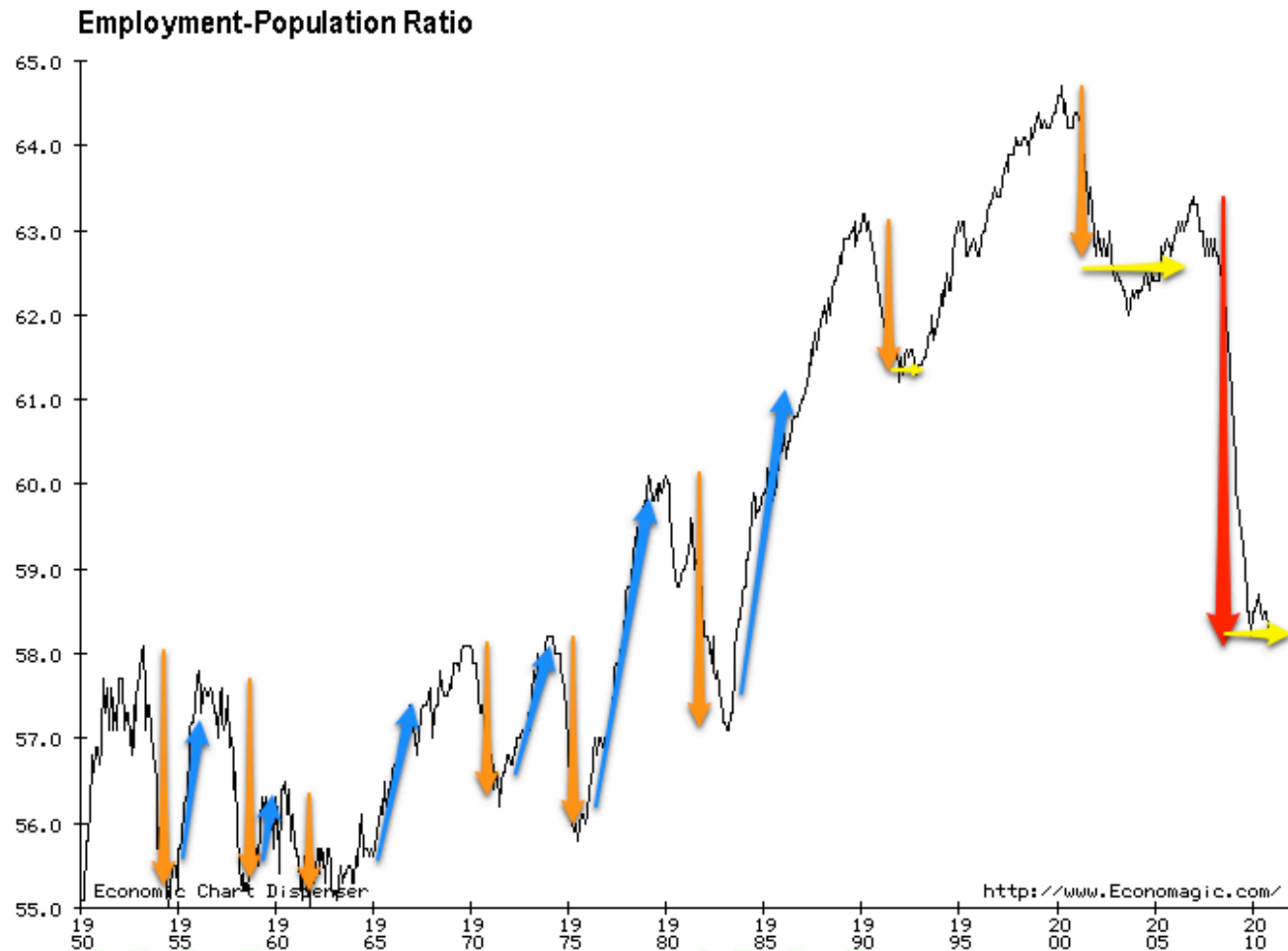
- Why does the employment-to-population ratio fluctuate so?
  - It's not because we forget how to make things.
  - It's not (so far) because we run out of resources.
  - It's not because we lose our taste for showing up to work.
- I want you to notice three things about this graph.



- Feminism
  - Remember Sandra Day O'Connor?
  - I would not claim that we have gender equality in the U.S. today, but things used to be much worse

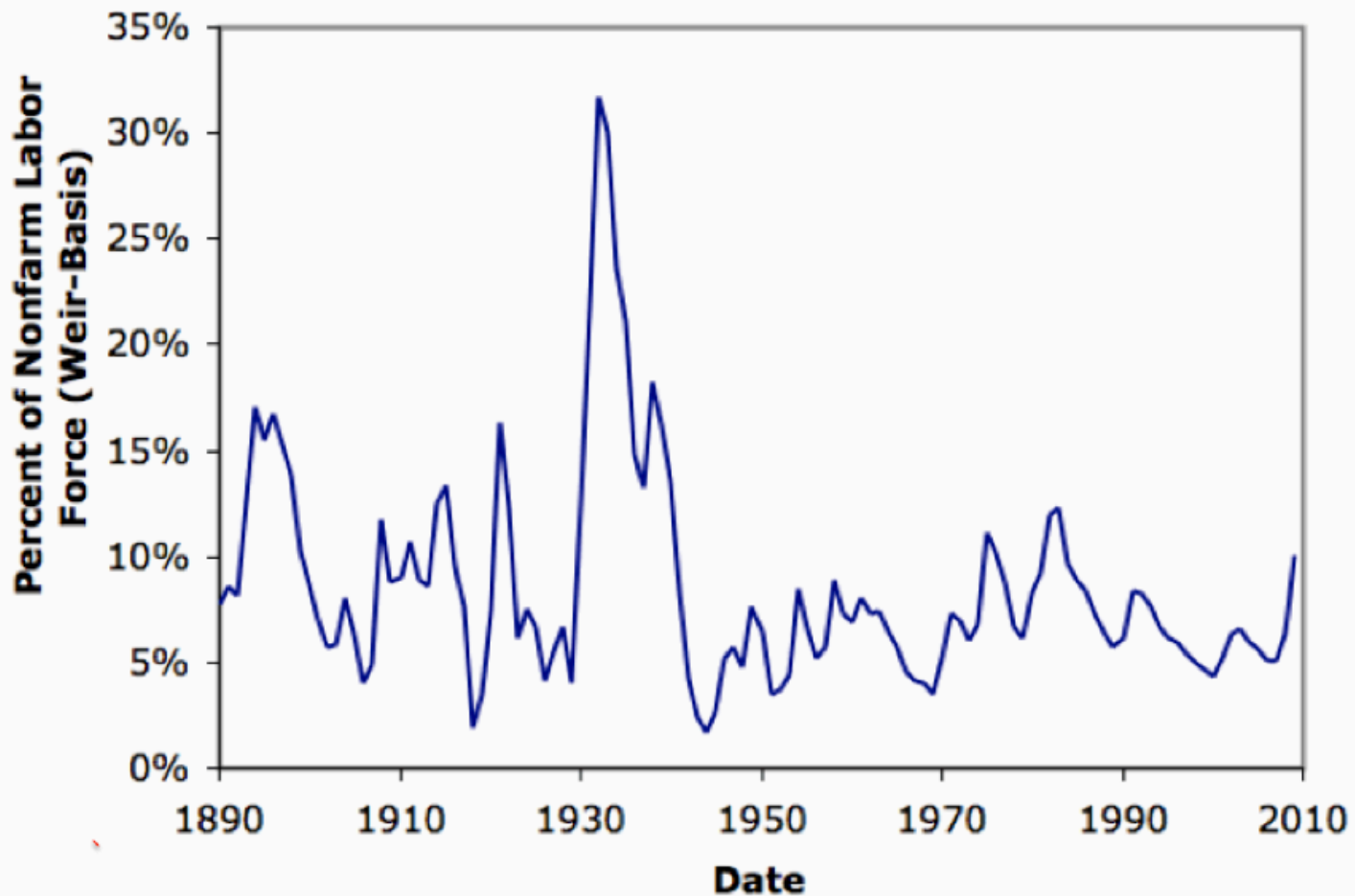


- The seasonal cycle
  - An extra  $\frac{1}{2}\%$  of America's adults are without jobs in January
  - An extra  $\frac{1}{2}\%$  of America's adults have jobs in October
- It's not because workers don't want to work as much in January
- It's because demand is lower in January—and the system isn't flexible enough to adjust.

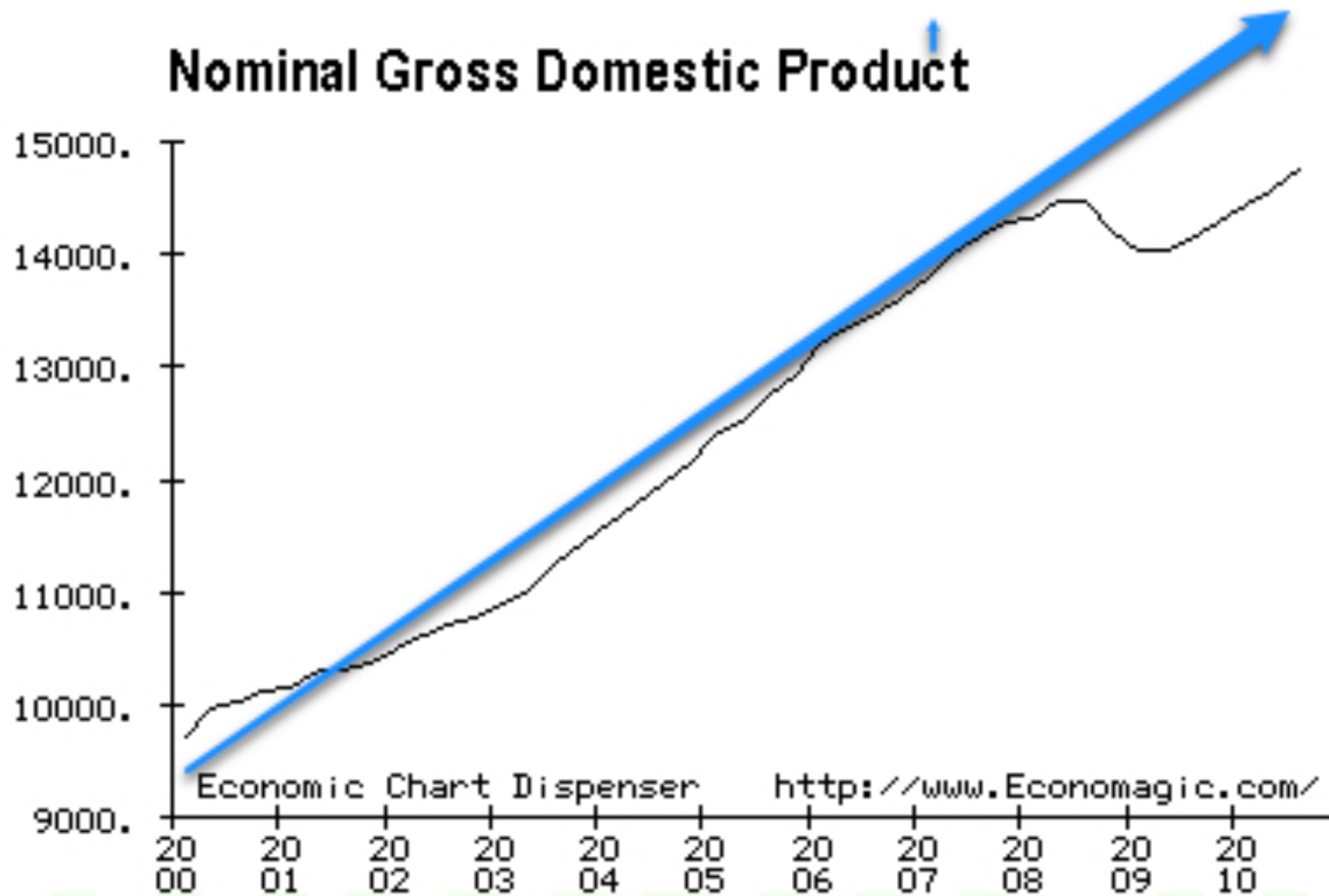


- The business cycle
  - Periodic collapses in the share of the population who have jobs
  - Our current one the most severe since the Great Depression of the 1930s itself
  - Vs and Ls

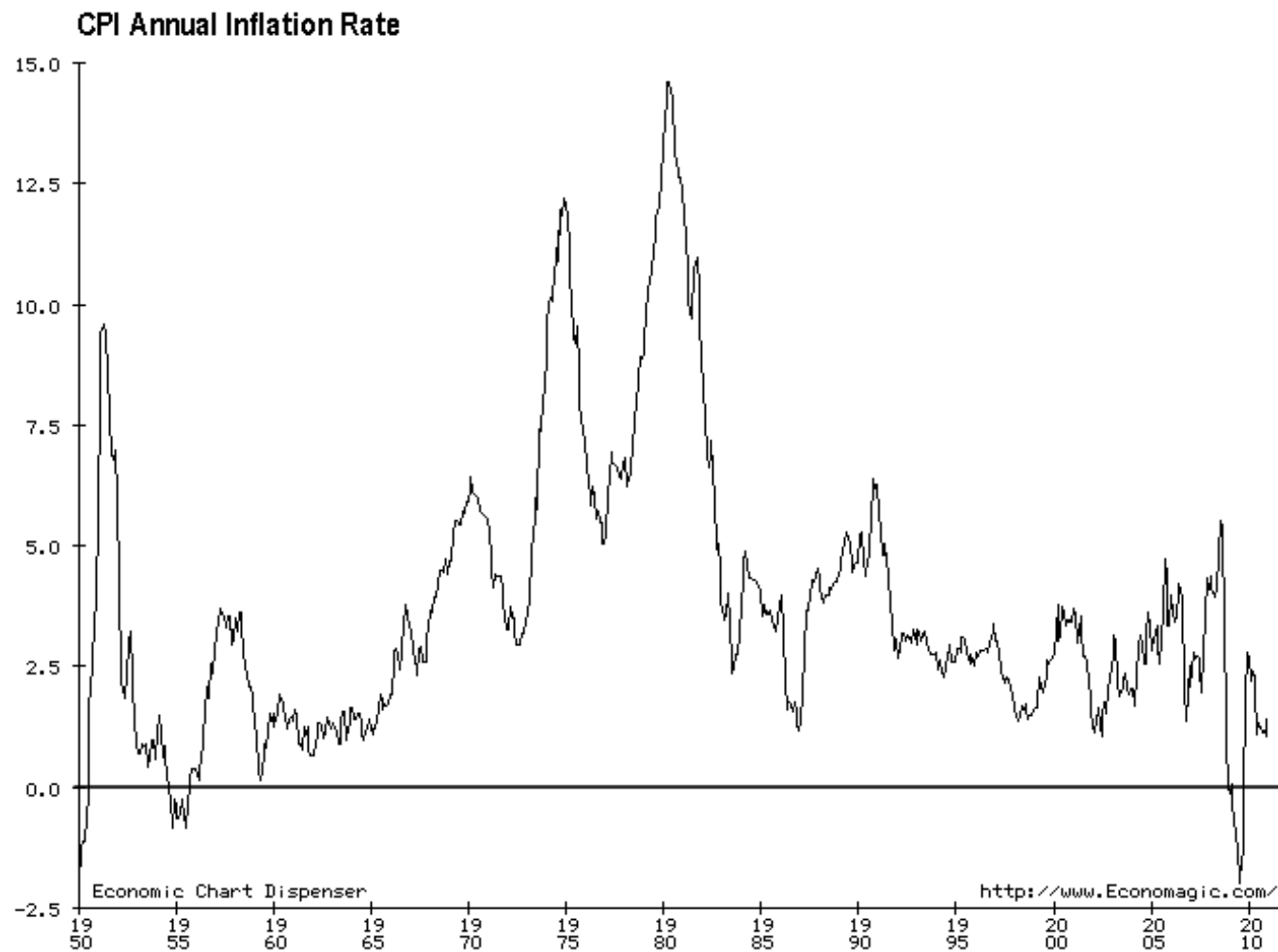
## Nonfarm Unemployment Rate



- But this is nowhere near as bad as the Great Depression was.
- Farm workers are in general not unemployed, so look at the nonfarm unemployment rate
- The current “Great Recession” does not look nearly as bad as any of the major pre-1929 downturns



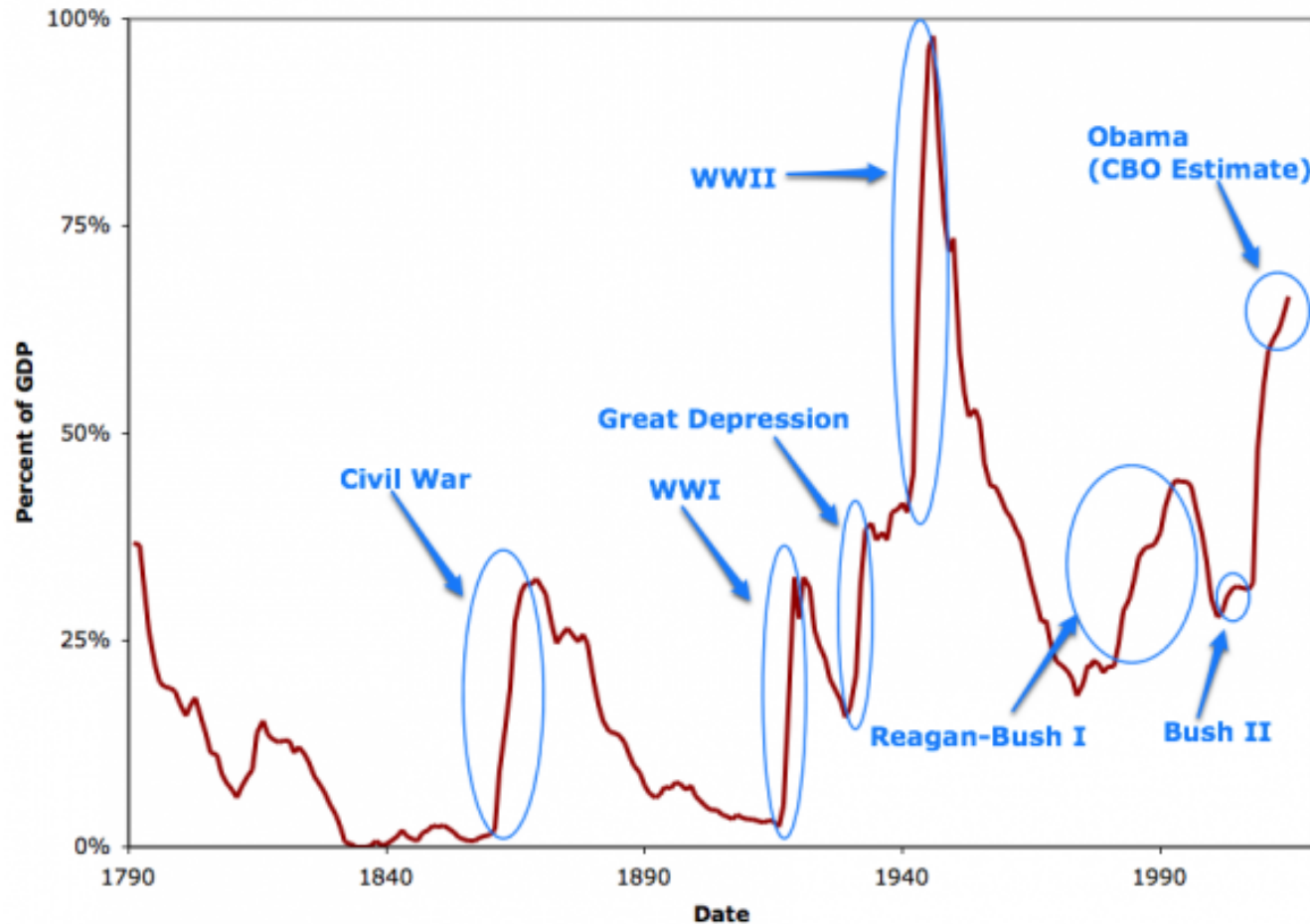
- Why the business cycle?
- Because the pace of spending collapsed
  - And that caused incomes to collapse, which caused spending to collapse further
- Spending collapsed because panicked savers and businesses decided they had to build up their holdings of safe financial assets.



- **Inflation Economics:**

- Inflation is annoying to voters
- A sign of governmental incompetence
- An extra, unnecessary source of risk
- Degrades the functioning of the price system (but not in and of itself a reduction in wealth)

## Federal Debt Truly Held by the Public/GDP



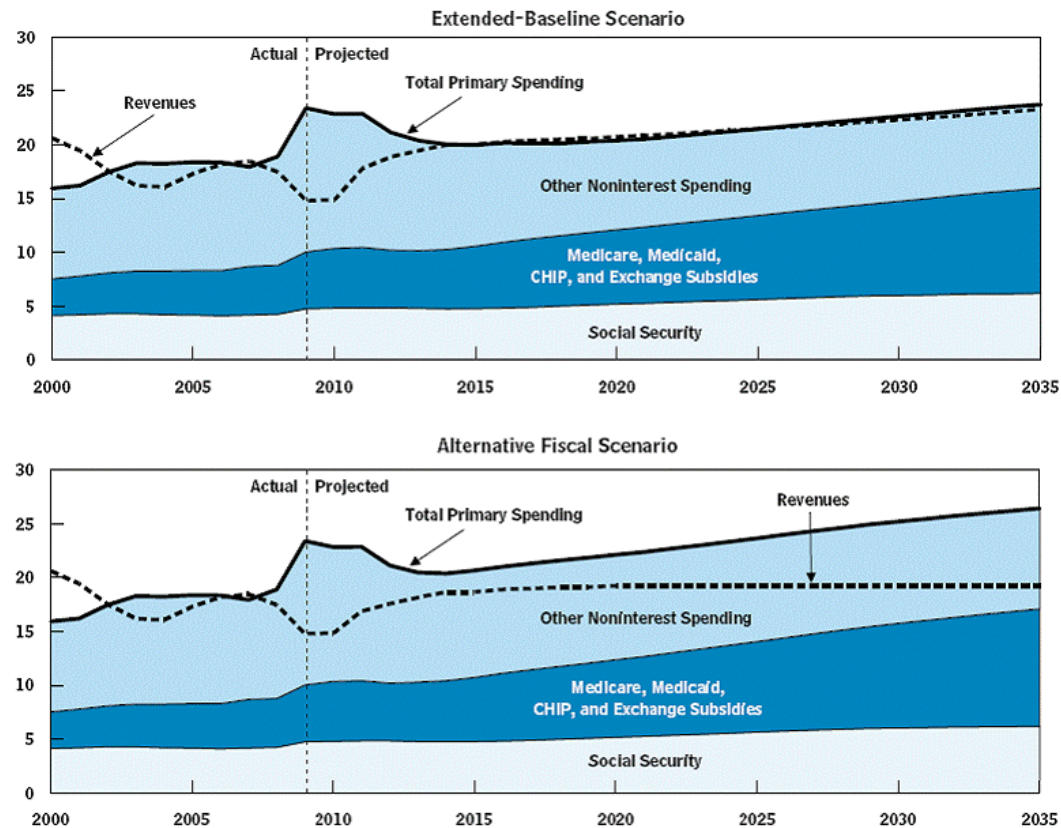
- **Debt-and-Deficit Economics:** The U.S. government budget
  - Historically, we run deficits in wars and depressions—and real surpluses to reduce the debt-to-GDP ratio in other times.
  - Reagan, Bush I, and Bush II are the big exceptions to this pattern.
  - But we have a policy dilemma when we look forward.



**Figure 1-1.**

**Revenues and Primary Spending, by Category, Under CBO's Long-Term Budget Scenarios**

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: Primary spending refers to all spending other than interest payments on federal debt.

The extended-baseline scenario adheres closely to current law, following CBO's 10-year baseline budget projections through 2020 (with adjustments for the recently enacted health care legislation) and then extending the baseline concept for the rest of the long-term projection period. The alternative fiscal scenario incorporates several changes to current law that are widely expected to occur or that would modify some provisions that might be difficult to sustain for a long period. (For details, see Table 1-1 on page 3.)

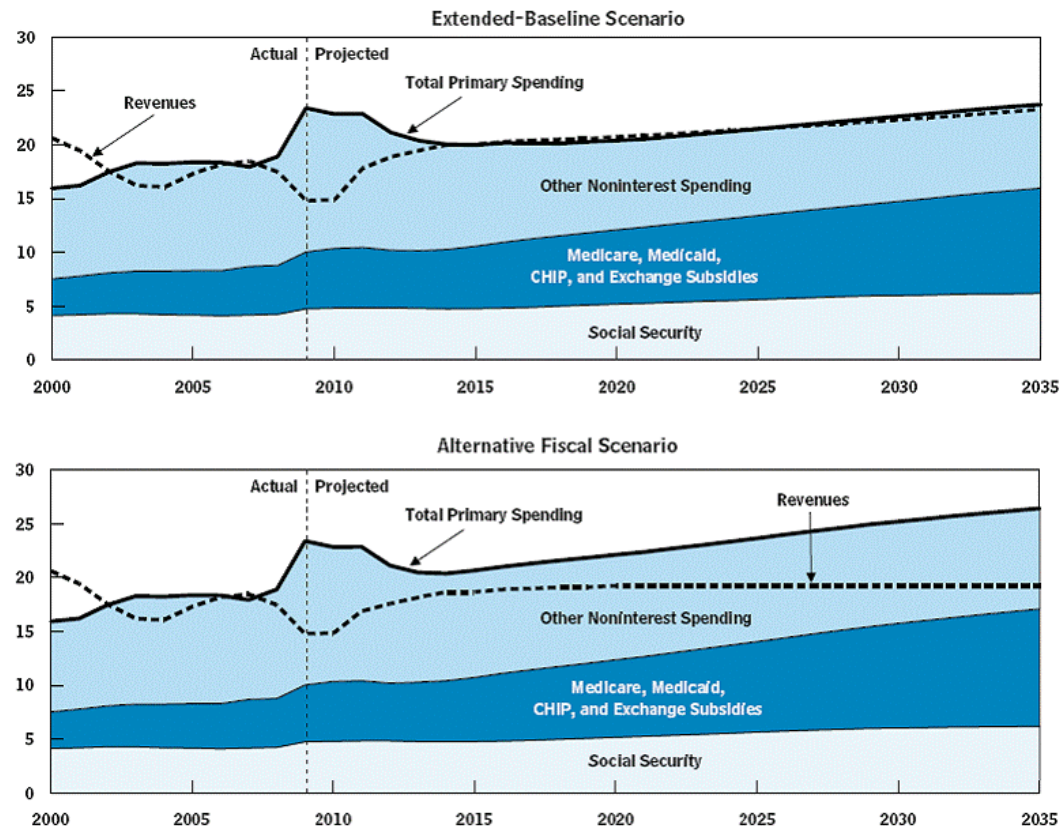
CHIP = Children's Health Insurance Program.

- According to “current law,” the U.S. budget is projected to be in balance, but:
  - The U.S. congress is unlikely to raise taxes on the upper-middle class by allowing the AMT to apply
  - The U.S. congress is unlikely to reduce Medicare payouts to doctors to the SGR targets.
  - The U.S. congress is unlikely to allow the ACA’s tax on high-cost health plans to go into effect
  - The U.S. congress is unlikely to let the IPAB cut Medicare payouts to doctors even further.
- The Alternative Fiscal Scenario then says what is likely to happen.

**Figure 1-1.**

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CHIP = Children's Health Insurance Program.

- The Alternative Fiscal Scenario then says what is likely to happen.
- It does not look pretty.
- We will have to cut spending below what congress would naturally do or raise taxes above what congress would naturally do?
- Voters? Voters don't want taxes raised and don't want benefits cut below current projected growth paths.
- What happens if we do not resolve this policy dilemma well? Bad things.
- Crowding out as savings devoted to domestic uses that would go to productive investment go into government bonds instead.
- A fall in savings as people fear future confiscatory taxation when the budget situation is resolved: uncertain taxes are the worst taxes.
- The possibility of hyperinflation and the breakdown of the market economy.

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

- **About how much bigger is total world GDP now than it was 10,000 years ago?**
  - A. About 14 times bigger
  - B. About 17000 times bigger
  - C. About 1200 times bigger
  - D. It's a silly question: you cannot possibly make such comparisons.
  - E. It's a silly question: what the answer is depends on what your tastes and preferences are, and everybody is different.

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

- **Are you currently enrolled in this class?**
  - A. Yes, and I intend to take this class
  - B. Yes, but I intend to drop this class
  - C. No, but I want to take this class if I can get in off the waitlist
  - D. No, and I'm not going to show up on Thursday

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

- **Who are you?**
  - A. First-year
  - B. Second-year
  - C. Third-year
  - D. Fourth-year
  - E. Other

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

- **Who are you II?**
  - A. Republican
  - B. Democrat
  - C. Communitarian
  - D. Authoritarian
  - E. Libertarian

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

- **Where did you take Econ 1?**
  - A. Last semester here at Berkeley, and I learned a lot.
  - B. Last semester here at Berkeley, and I learned nothing at all.
  - C. Before last semester here at Berkeley.
  - D. In high school as an AP course.
  - E. at some other university.

# Test Your Knowledge

- What three major features jump out at you when you look at the post-WWII U.S. employment-to-population ratio?
- Why and how is “macroeconomics” different from plain vanilla economics?
- What are the four principal parts of macroeconomics?
- Why are the years 2008-20011 called the “Great Recession” or the “Long Slump”?
- Why isn’t this a good course for Haas majors to take?