Economics 1: Introduction to Economics

J. Bradford DeLong <delong@econ.berkeley.edu>
To Your i>Clickers...

• Did you go to see Amartya Sen yesterday?
  A. Yes...
  B. No...
To Your i>Clickers...

• The midterm was...
  A. Too short and too easy to allow me to show what I knew...
  B. Too short and too hard to allow me to show what I knew...
  C. Too long and too easy to allow me to show what I knew...
  D. Too long and too hard to allow me to show what I knew...
  E. Just right...
Administrivia

March 14, 2016 8-9 AM
Wheeler Auditorium, U.C. Berkeley
Meta-Announcement

• We are moving announcements and administrivia out of lecture time and onto the “announcements” bCourses page...

• That is all...
In the near future...

• 2016-03-14 Mo: Income distribution and moral philosophy...
• 2016-03-16 We: Public goods, public finance, and political economy...
• 2016-03-28 Mo: We start “macroeconomics”...
• 2016-03-28/29 Mo/Tu: Short essay due...
Orientation

March 14, 2016 8-9 AM
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“The Market” as an Institution

• We start from what look like to us deep truths of human psychology
  • People are *acquisitive*
  • People engage in *reciprocity*—i.e., want to enter into reciprocal gift-exchange relationships in which they are neither cheaters nor saps
  • With those they *trust*...
“The Market” as an Institution II

- We devised property as a way of constructing expectations of trust...
- We devised money as a substitute for trust...
- And so, on the back of these human propensities for acquisition and for trusted gift-exchange, we have constructed a largely-peaceful global 7.4B-strong highly-productive societal division of labor:
  
  - Built on assigning things to owners—who thus have responsibility for stewardship and the incentive to be good stewards...
  - And on very large-scale webs of win-win exchange...
  - Regulated by market prices...

- This is a very valuable and important societal institution...
- Economics is the study of how it—what we usually call “the market”—works...
The Market Balance Sheet: Pro

- The market failure-free competitive market in equilibrium, from the perspective of a utilitarian seeking to achieve the greatest-good-of-the-greatest-number, accomplishes these goals:

1. It produces at a scale that exhausts all possible win-win exchanges—and is “efficient” in that sense.
2. It allocates the roles of producers and sellers to those who can make and sell them in a way least costly to society’s overall resources—to those with the lowest opportunity cost.
3. It rations the goods produced to those with the greatest willingness-to-pay—to those who, by the money standard, need and want them the most.
The Market Balance Sheet: Con

• Markets can go wrong. We have covered how they can:
  1. not fail but be failed by governments that fail to properly structure and support them—or that break them via quotas or price floors/ceilings
  2. be out-of-equilibrium
  3. have market power
  4. be non-rival (increasing returns to scale; natural monopolies)
  5. suffer externalities (in production and in consumption, positive and negative; closely related to non-excludibility)
  6. suffer from information lack or asymmetry

• Today we cover
  7. **suffer from maldistributions**

• We will cover
  8. be non-excludible (public goods, etc.)
  9. suffer from miscalculations and behavioral biases
The Bengal Famine of 1943

March 14, 2016 8-9 AM
Wheeler Auditorium, U.C. Berkeley
## Bengal in 1943

### Table 6.2

*Foodgrains Availability in Bengal, 1938–43*

<table>
<thead>
<tr>
<th>Period</th>
<th>Output of rice (official estimates)</th>
<th>Net imports of rice (official estimates)</th>
<th>Current supply of rice (official)</th>
<th>Adjusted output of rice</th>
<th>Adjusted current supply of rice</th>
<th>Rice and wheat: adjusted current supply</th>
<th>Index of total foodgrains supply</th>
<th>Index of per capita foodgrains availability</th>
</tr>
</thead>
<tbody>
<tr>
<td>1938</td>
<td>8.474</td>
<td>0.033</td>
<td>8.507</td>
<td>9.848</td>
<td>9.938</td>
<td>10.017</td>
<td>123</td>
<td>127</td>
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<tr>
<td>1939</td>
<td>7.922</td>
<td>0.382</td>
<td>8.304</td>
<td>9.114</td>
<td>9.596</td>
<td>9.787</td>
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<td>120</td>
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<tr>
<td>1940</td>
<td>8.223</td>
<td>0.258</td>
<td>8.481</td>
<td>9.524</td>
<td>9.882</td>
<td>10.196</td>
<td>122</td>
<td>123</td>
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<td>1941</td>
<td>6.768</td>
<td>0.223</td>
<td>6.991</td>
<td>7.631</td>
<td>7.954</td>
<td>8.332</td>
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<tr>
<td>1942</td>
<td>9.296</td>
<td>−0.102</td>
<td>9.194</td>
<td>10.776</td>
<td>10.774</td>
<td>10.947</td>
<td>131</td>
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<tr>
<td>1943</td>
<td>7.628</td>
<td>0.264</td>
<td>7.892</td>
<td>8.632</td>
<td>8.896</td>
<td>9.235</td>
<td>111</td>
<td>109</td>
</tr>
</tbody>
</table>

**II Moving averages:**
- 2 years
  - 1939–40: 8.393
  - 1940–41: 7.736
  - 1941–42: 8.093
  - 1942–43: 8.543

**III Moving averages:**
- 3 years
  - 1938–40: 8.431
  - 1939–41: 7.925
  - 1940–42: 8.222
  - 1941–43: 8.026
Bengal in 1943

- So why, then, did 3 million people starve to death in Bengal in 1943?

- 1/20 of the entire population of the province back then...

- Amartya Sen and the story of the Bengal famine

- A point that generalizes far...

- Especially in a very unequal world...
The Market Seeks the Greatest Good of the Greatest Number of Dollars

- There was a boom in Bengal in 1943...

- A surge in prices as the United Nations armies further east needed supplies...

- But there was no boom in demand for unskilled rural agricultural labor...

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<th>Mid-month</th>
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<th>Rice: price index</th>
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<tr>
<td>1941</td>
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<tr>
<td>December</td>
<td>0.14</td>
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<tr>
<td>1942</td>
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<tr>
<td>September</td>
<td>0.16</td>
<td>114</td>
<td>0.37</td>
<td>100</td>
<td>88</td>
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<td>October</td>
<td>0.25</td>
<td>179</td>
<td>0.37</td>
<td>100</td>
<td>56</td>
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<tr>
<td>November</td>
<td>0.31</td>
<td>221</td>
<td>0.31</td>
<td>84</td>
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<td>December</td>
<td>0.25</td>
<td>179</td>
<td>0.44</td>
<td>119</td>
<td>66</td>
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<td>1943</td>
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<tr>
<td>January</td>
<td>0.27</td>
<td>193</td>
<td>0.50</td>
<td>135</td>
<td>70</td>
</tr>
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<td>February</td>
<td>0.25</td>
<td>179</td>
<td>0.50</td>
<td>135</td>
<td>75</td>
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<tr>
<td>March</td>
<td>0.38</td>
<td>271</td>
<td>0.44</td>
<td>119</td>
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<tr>
<td>April</td>
<td>0.52</td>
<td>371</td>
<td>0.50</td>
<td>135</td>
<td>36</td>
</tr>
<tr>
<td>May</td>
<td>0.78</td>
<td>557</td>
<td>0.50</td>
<td>135</td>
<td>24</td>
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<tr>
<td>June</td>
<td>0.72</td>
<td>514</td>
<td>0.50</td>
<td>135</td>
<td>26</td>
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<tr>
<td>July</td>
<td>0.73</td>
<td>521</td>
<td>0.53</td>
<td>143</td>
<td>27</td>
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<tr>
<td>August</td>
<td>0.75</td>
<td>536</td>
<td>0.62</td>
<td>168</td>
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<td>1944</td>
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<td>January</td>
<td>0.36</td>
<td>257</td>
<td>0.62</td>
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<td>65</td>
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The Market Seeks the Greatest Good of the Greatest Number of Dollars II

- But there was no boom in demand for unskilled rural agricultural labor...
- Hence wages don’t go up
- But the price of rice does
- And so you starve to death...

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The Felicific Calculus of the Market

March 14, 2016 8-9 AM
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Let’s Build a Benthamite Utilitarian Model of This...

- The wealthy have income $W$: they spend their income buying $W/P$ units of food to make themselves happy...

- The destitute have income $D$: they spend their income buying $D/P$ units of food to make themselves happy...

- There are $Q$ units of food available...

- What does the market decide to do?
Let’s Build a Benthamite Utilitarian Model of This… II

• Here we have the pre-famine situation...

• The supply and demand for food produce equilibrium

• The wealthy consume somewhat more food than the destitute
Let’s Build a Benthamite Utilitarian Model of This... III

• Now let’s add a boom...

• The blue demand for food by the wealthy moves up...

• The new equilibrium has a much higher price of food...
Let’s Build a Benthamite Utilitarian Model of This… IV

- Food consumption by the destitute falls—drastically...
- Food consumption by the rich rises...
- Why? Because the market “cares” more about the rich than the poor...
- And the amount by which the market “cares” more about the rich is proportional to the distribution of income
And with a Superboom in the Income of the Wealthy…

- Food consumption by the destitute falls by even more...

- The market takes willingness-to-pay as its indicator of how much you “need” or “deserve” something...

- And willingness-to-pay depends on more than your preferences...

- It also depends on and scales with your income and wealth...
Global Inequality

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America, Britain, China, and Nigeria 1800-1977
America, Britain, China, and Nigeria 1800-2015
The World 1800

![Chart showing life expectancy and GDP per capita for various countries in 1800. The United States is highlighted.]
The World 2015
Within-America Inequality

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American Income Shares: The Top Tenth

FIGURE 1
The Top Decile Income Share, 1917-2014

Source: Table A1 and Table A3, col. P90-100.
Income is defined as market income (and excludes government transfers).
In 2014, top decile includes all families with annual income above $121,400.
The Top Tenth

• From 45% down to 34% with the end of the first Gilded Age, the Great Depression, and the coming of World War II

• From 34% back up to 50% today

• Is it going higher?

• What are the causes?
  • The vicissitudes of the plutocracy
  • Substantial swings in the college-high school wage premium
    • From 100% down to 30% as education wins the race between education and technology in the 1940s and 1950s
    • From 30% back up to 80% since 1975 as education loses the race against technology
The Top 17,000 Taxpaying Units

Figure 3: The Top 0.01% Income Share, 1913-2014

Source: Table A1 and Table A3, col. P99.99-100.

Income is defined as market income including (or excluding) capital gains.

In 2014, top .01% includes the 16,500 top families with annual income above $9.75m.
The Top 17,000 Taxpaying Units

• The vicissitudes of the plutocracy
• From 3% of all income down to 1%…
• And from 1% up to 5%…
• More than $10 million/year
  • Heirs and heiresses
  • Financiers
  • Corporate executives
  • Empire-builders
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