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

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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

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Bengal in 1943

TABLE 6.2

Foodgrains Availability in Bengal, 1938–43

Period	Output of rice (official estimates)	Net imports of rice (official estimates)	Current supply of rice (official)	Adjusted output of rice	Adjusted current supply of rice	Rice and wheat: adjusted current supply	Index of total foodgrains supply	Index of per capita foodgrains availability
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
I Annual data								
1938	8.474	0.033	8.507	9.848	9.981	10.217	123	127
1939	7.922	0.382	8.304	9.114	9.596	9.787	118	120
1940	8.223	0.258	8.481	9.524	9.882	10.196	122	123
1941	6.768	0.223	6.991	7.631	7.954	8.332	100	100
1942	9.296	−0.102	9.194	10.776	10.774	10.947	131	130
1943	7.628	0.264	7.892	8.632	8.896	9.235	111	109
II Moving averages: 2 years								
1938–39			8.406		9.789	10.002	120	123
1939–40			8.393		9.739	9.992	120	122
1940–41			7.736		8.918	9.264	111	112
1941–42			8.093		9.364	9.640	116	115
1942–43			8.543		9.835	10.091	121	119
III Moving averages: 3 years								
1938–40			8.431		9.820	10.067	121	123
1939–41			7.925		9.144	9.438	113	114
1940–42			8.222		9.537	9.825	118	118
1941–43			8.026		9.208	9.505	114	113

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…

Mid-month	Rice (no. 2): Rs. per seer	Rice: price index	Wage: Rs. per day	Wage index	Exchange rate index: labour vis-à-vis rice
1941					
December	0.14	100	0.37	100	100
1942					
September	0.16	114	0.37	100	88
October	0.25	179	0.37	100	56
November	0.31	221	0.31	84	38
December	0.25	179	0.44	119	66
1943					
January	0.27	193	0.50	135	70
February	0.25	179	0.50	135	75
March	0.38	271	0.44	119	44
April	0.52	371	0.50	135	36
May	0.78	557	0.50	135	24
June	0.72	514	0.50	135	26
July	0.73	521	0.53	143	27
August	0.75	536	0.62	168	31
September	0.50	357	0.50	135	38
October	0.56	400	0.56	151	38
November	0.44	314	0.56	151	48
December	0.33	236	0.69	186	79
1944					
January	0.36	257	0.62	168	65

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

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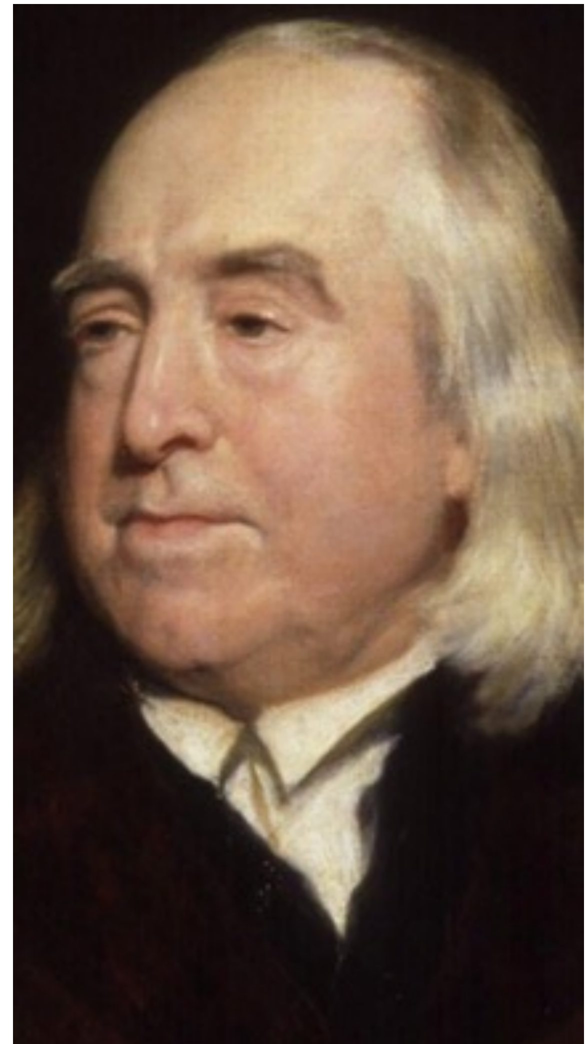
Let's Build a Benthamite Utilitarian Model of This…

- 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?

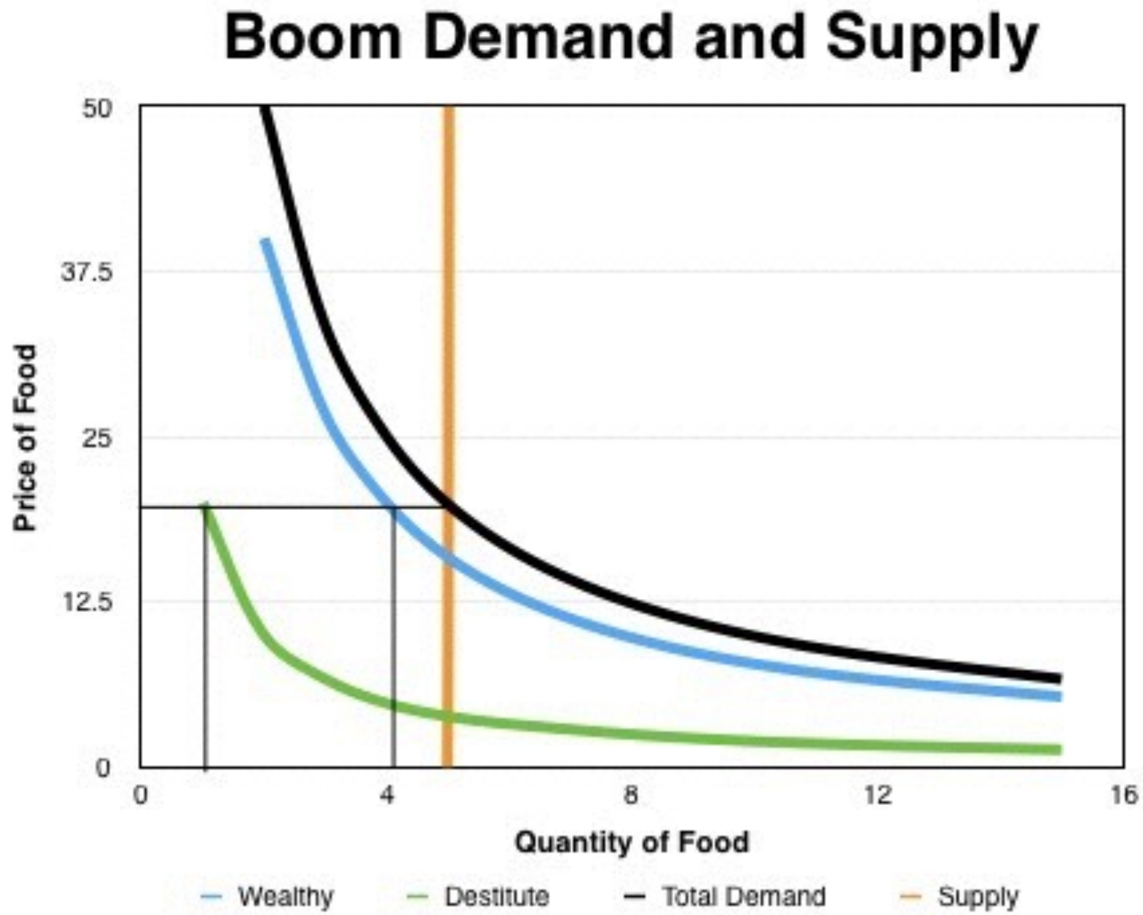


Let's Build a Benthamite Utilitarian Model of This… II

- Here we have the pre-famine situation…
- The supply and demand for food produce equilibrium
- The wealthy consume somewhat more food than the destitute

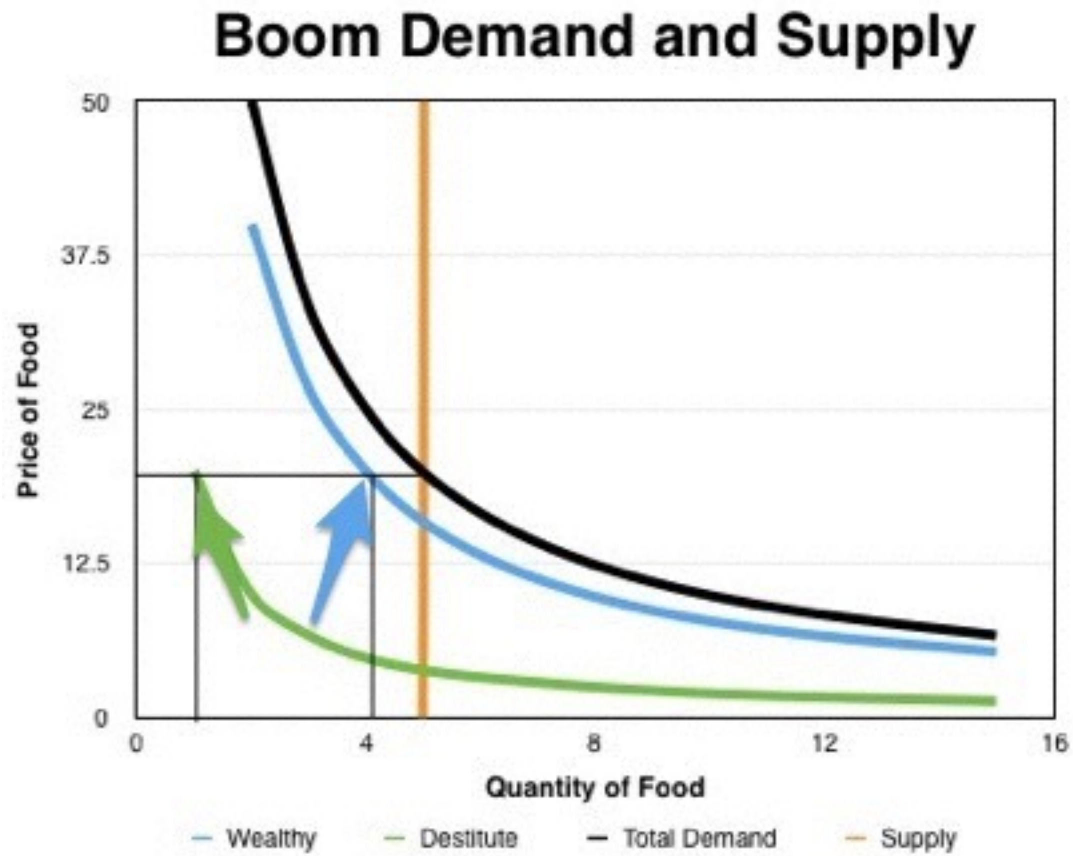
Let's Build a Benthamite Utilitarian Model of This… III

- 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…



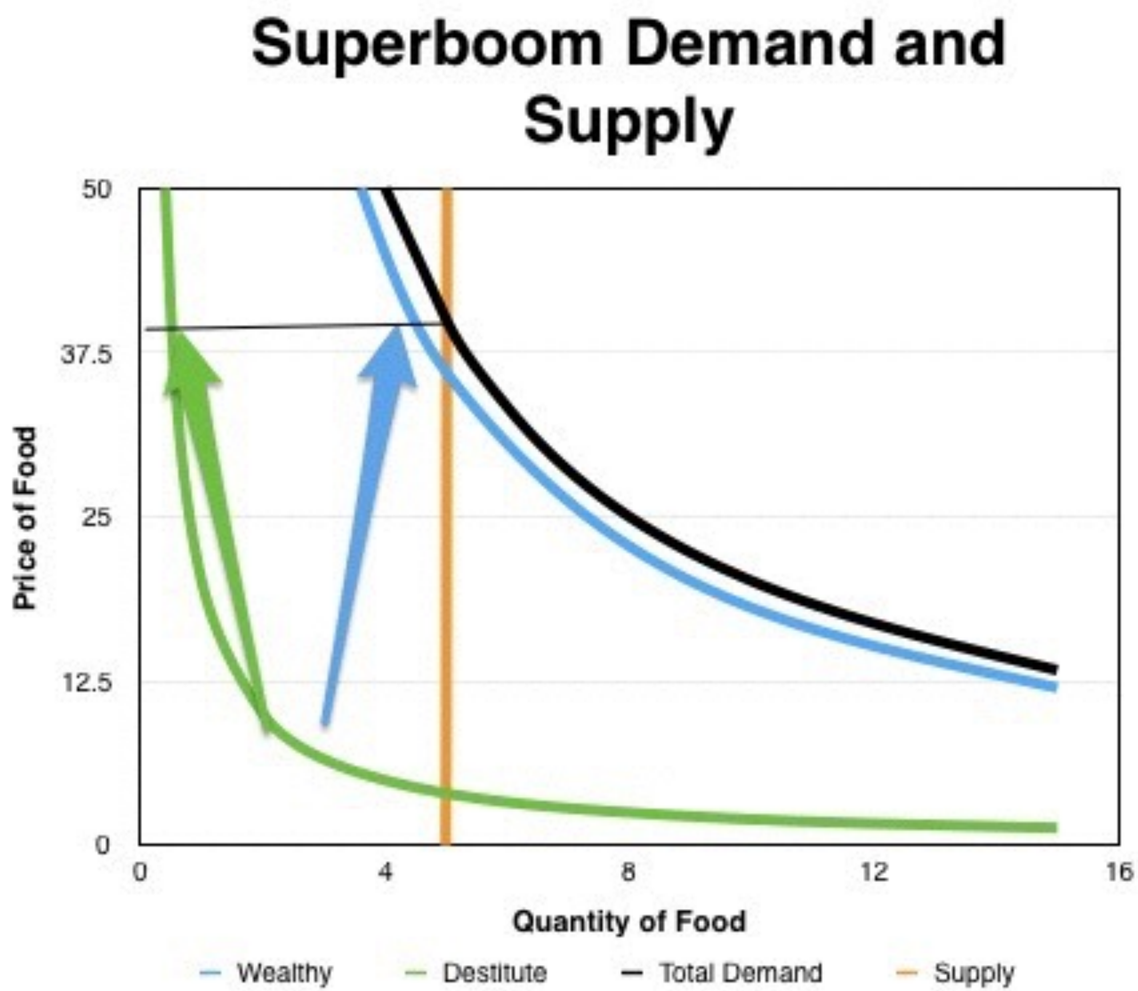
Let's Build a Benthamite Utilitarian Model of This… IV

- 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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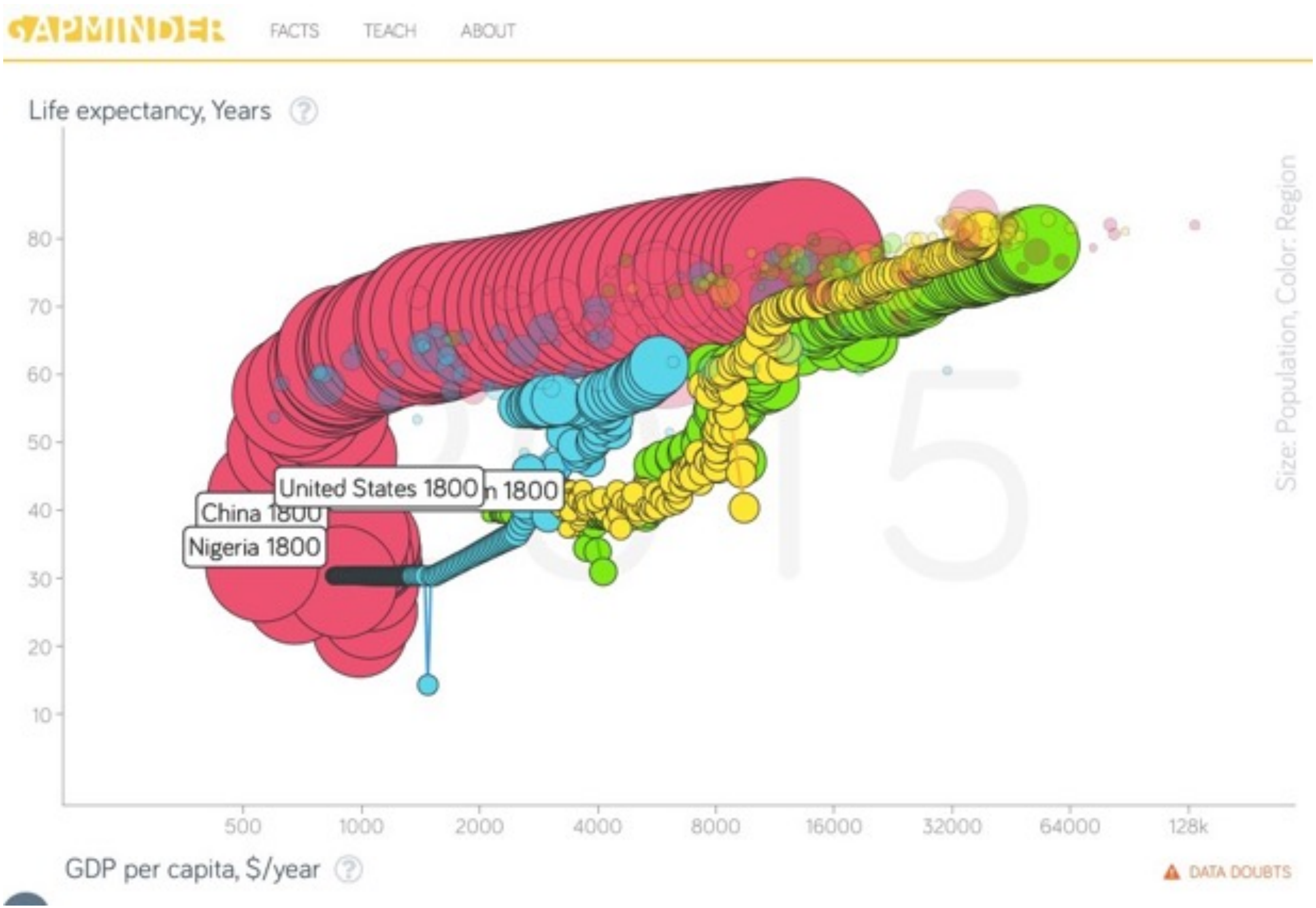
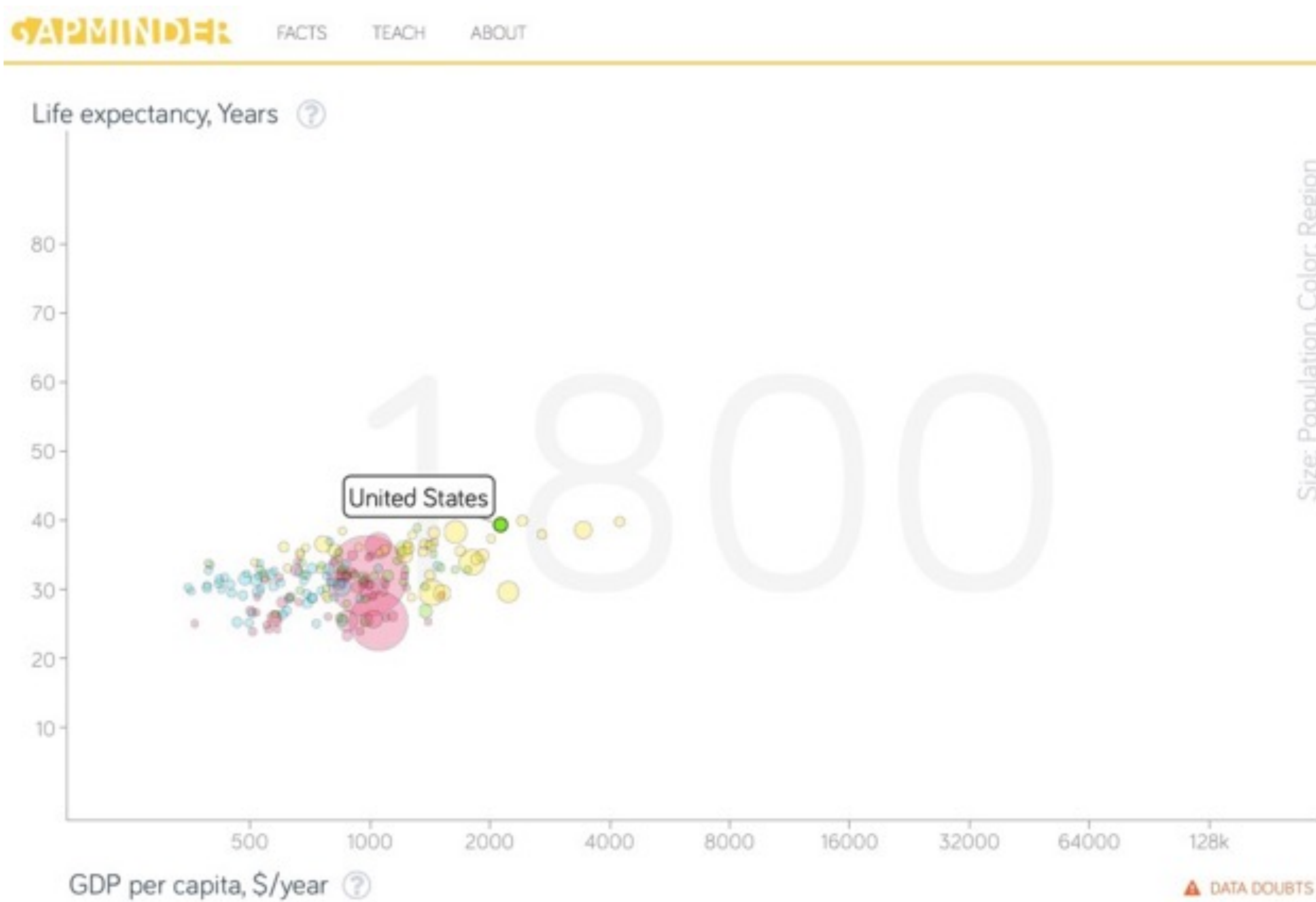
America, Britain, China, and Nigeria 1800-1977

America, Britain, China, and Nigeria 1800-2015

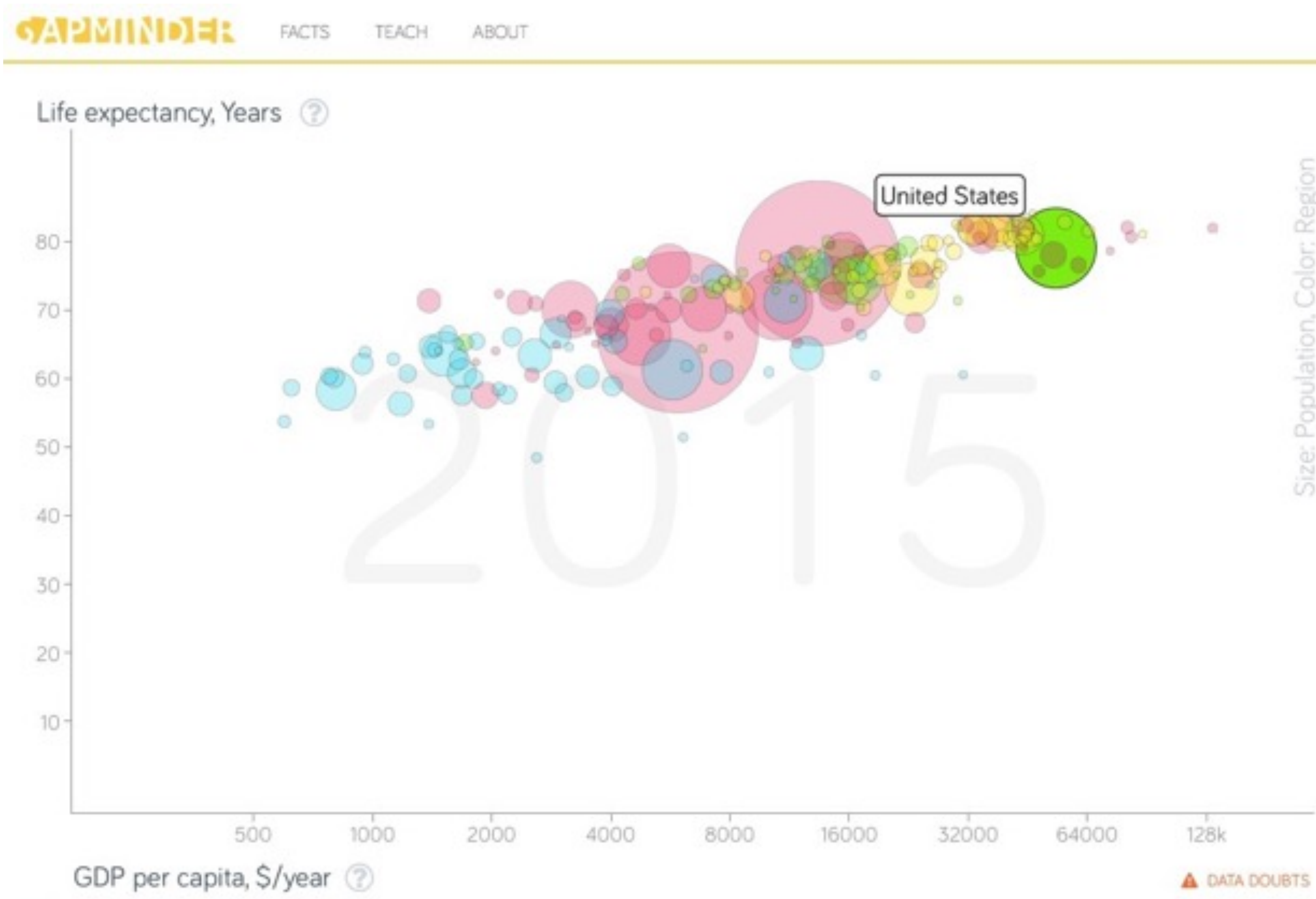


America 1800-2015

The World 1800



The World 2015



Within-America Inequality

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American Income Shares: The Top Tenth

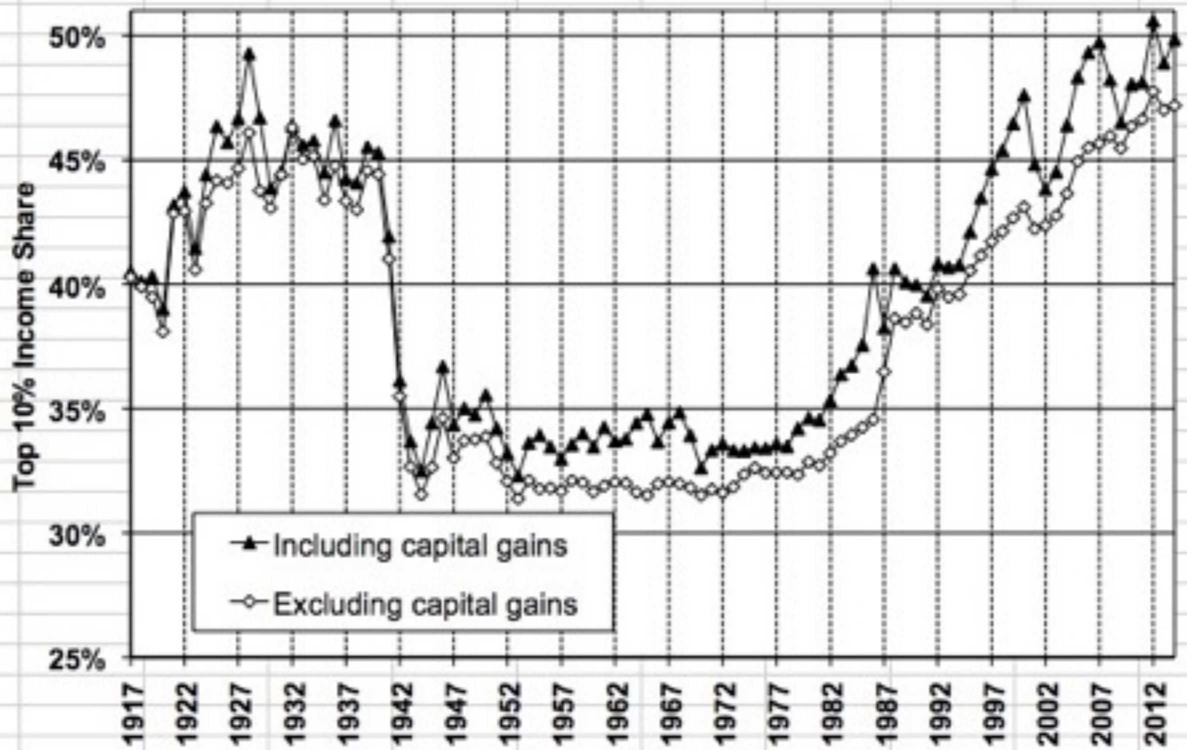

FIGURE 1

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

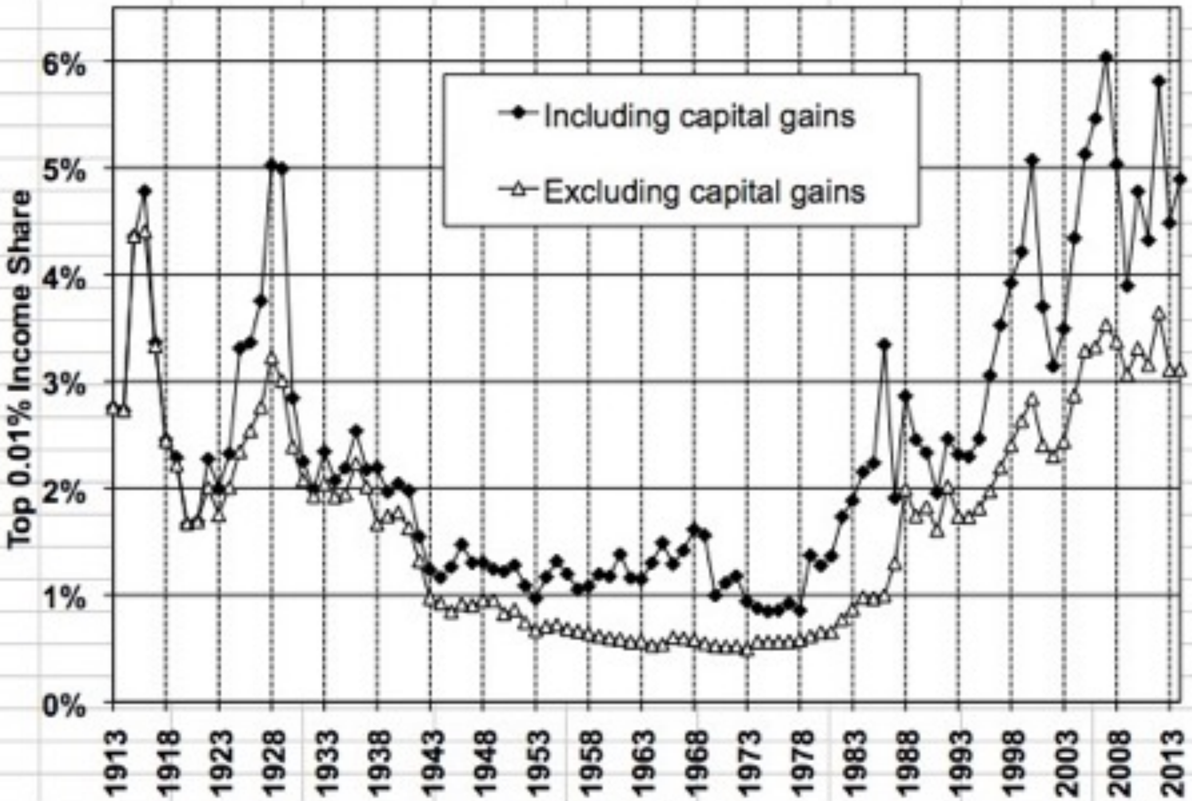

FIGURE 3

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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