

Economics 1: Introduction to Economics: January 20, 2016 Lecture

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Economics 1: Spring 2016: Course Intro

January 20, 2016 8-0 AM
Wheeler Auditorium, U.C. Berkeley

Welcome to Econ 1: Spring 2016: UC Berkeley

- **J. Bradford DeLong**
 - delong@econ.berkeley.edu : MW 8:00 AM Wheeler Auditorium
 - This document: <<https://bcourses.berkeley.edu/courses/1411451/assignments/syllabus>>
 - Office Hours: J. Bradford DeLong's office hours for undergraduates will start January 26, and will be Tuesday 9-11 in Evans Hall 591.
- **Required Purchases:**
 - Robert Frank, Ben Bernanke, Kate Antonovics, and Ori Heffetz: Principles of Economics <<http://amzn.to/1Zpuoj5>> (New York: McGraw-Hill: 9781259897580) be sure to order and buy ISBN 9781259897580 from the Berkeley bookstore
 - Partha Dasgupta (2007): Economics: A Very Short Introduction <<http://amzn.to/1ZpuFCQ>> (Oxford: Oxford University Press: 9780192853455)
 - Milton Friedman and Rose Director Friedman (1970): Free to Choose: A Personal Statement <<http://amzn.to/1NbvEPU>> (New York: Mariner Books: 9780156334600)
 - Tom Slee (2006): No One Makes You Shop at Wal-Mart: The Surprising Deceptions of Individual Choice <<http://amzn.to/234zCph>> (New York: Between the Lines: 9781897071069)
 - i>Clicker+ Student Remote <<http://amzn.to/1ZpvkEe>?> (New York: W.H. Freeman: 9781464120152)

Welcome to Econ 1: Spring 2016: UC Berkeley

- FIRST SECTION MEETINGS WILL BE WEDNESDAY 1/20 AND THURSDAY 1/21: There are no Monday or Tuesday sections the week of January 18
- YOU MUST ATTEND YOUR FIRST SECTION MEETING: If you fail to attend, you will be sent back to the waitlist.
- Useful Resources to keep at your fingertips for Econ 1: Spring 2016:
 - Econ 1 Questions at Piazza <<http://piazza.com>>: <<https://piazza.com/class/ijbycscre596wc>>
 - Econ 1 Chat: <https://bcourses.berkeley.edu/courses/1411451/external_tools/24485>
 - Econ 1 Announcements: <<https://bcourses.berkeley.edu/courses/1411451/announcements>>
- You are responsible for everything in the Course Policies document. READ IT! <<http://www.bradford-delong.com/course-policies.html>>

Things to Notice About This Course I

- This is one semester
 - Everywhere else this is a two semester course:
 - We go fast
- This is the University of California at Berkeley
 - Certainly the finest public university in the world
 - Perhaps the finest university in the world
 - Others could be in your seats
 - They would take advantage of the opportunities here
 - Don't waste your opportunity here
- This is a lecture hall: a pre-Gutenberg educational technology for a post-Gutenberg age
- We will do the best we can

Things to Notice About This Course II

- **Undergraduate Student Learning Initiative:** As part of Berkeley's Undergraduate Student Learning Initiative (USLI), the Economics Department has developed learning goals for the Economics major at: http://emlab.berkeley.edu/econ/ugrad/ugrad_goals.shtml. The specific learning goals which this course aims to achieve are:
 - CT1: understand everyday economic problems,
 - CT2: use economic theory to understand and evaluate policy proposals,
 - PS1: solve problems with clear solutions,
 - CS1: communicate effectively about economic issues, and
 - LL3: understand the economic news.
- But that is not terribly helpful, is it?

Things to Notice About This Course III: Economic Literacy

- The real learning goal for this course is: **economic literacy**.
- At the end of the course, students should be able to take any article about the economy, whether in, say, the *Financial Times* or the *Economist* or the *San Francisco Chronicle* or *Business Insider* or vox.com:
 - Determine what assertions it is making about
 - how the economy works, and
 - what the current state of the economy is,
 - break down those assertions,
 - use economic logic and economic models and economic data to analyze them, and
 - conclude whether and under what conditions the arguments of the article make sense.

Things to Notice About This Course IV: Grading and First Assignment

- Grading:
 - 30% final on May 9, 2016 3-6 PM
 - 15% midterm on March 9, 2016
 - 40% 9 problem sets and a short midterm paper.
 - 9% lecture participation—i>Clickers should start Monday.
 - 5% section participation.
 - 1% an introductory letter to your GSI,
 - Anticipated median grade in this course is a high B...
- First section assignment:
 - Read Partha Dasgupta, *Economics: A Very Short Introduction*

Letter of Introduction Assignment

- By the start of your next section meeting, please write a 250-word essay--a “letter of introduction”--to your GSI. Include your name, and discuss:
 - the reasons why you are choosing to spend 3% of your scarce college curriculum time taking this course this year,
 - what you hope to learn from this course,
 - what you hope to do in the future as a result of this course, and
 - whatever else about yourself that you would like to share with your GSI.
 - Please include or embed a photo of yourself, as this will help us learn to recognize you by sight.

Microeconomics Intro

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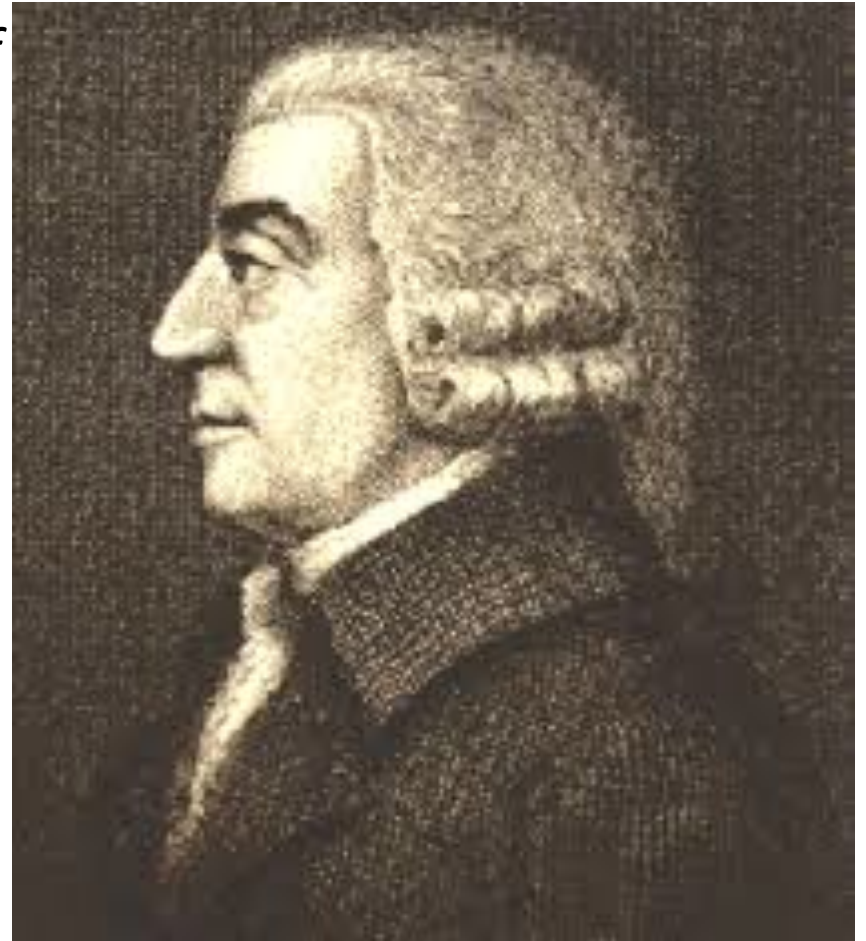
What Is Remarkable About the East African Plains Ape?

- Basic:
 - Mammals
 - Upright posture
 - A lot of us: 7.4 billion now
- Form:
 - Hands and opposable thumbs
 - Big brains
 - Talk
- Behavior:
 - Gossip (about food, threats, mating)
 - Alter our environment
 - Gift exchange
 - Large-scale social division of labor greater than seen in the social insects



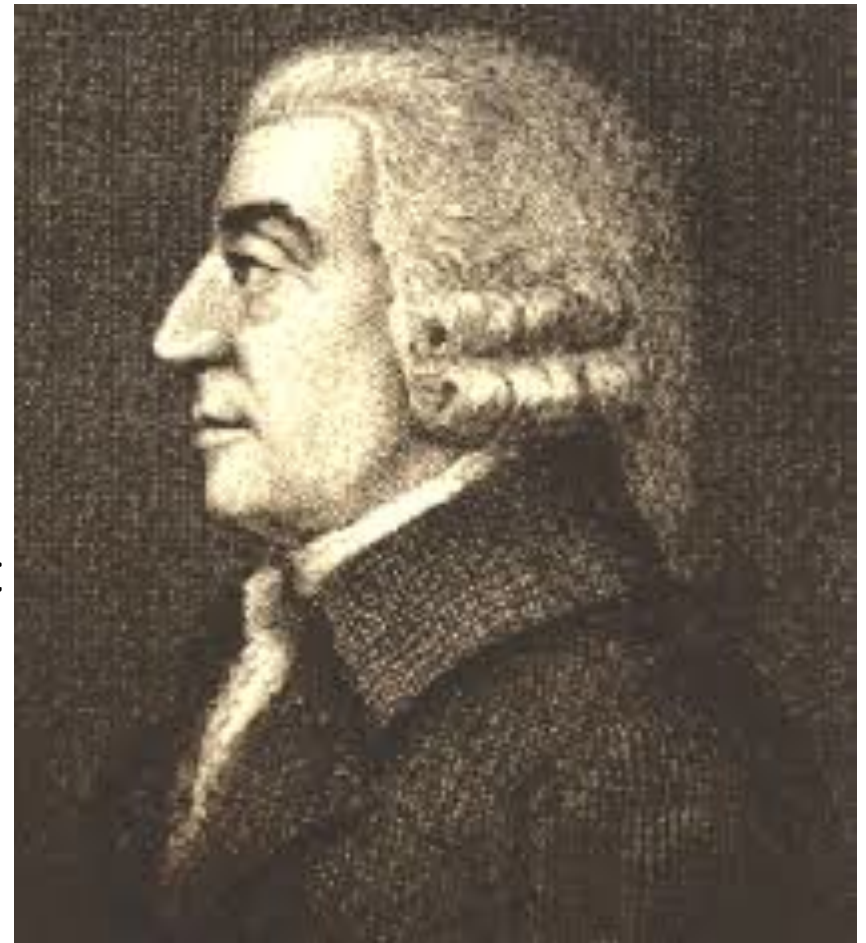
Adam Smith

- In 1776 publishes his *Wealth of Nations*
- It contains a genuinely game-changing insight: the “system of natural liberty”
- Just let people exchange things freely—in an environment in which property is secure, and in which there is an alternative deal almost as good just down the street—and things will work out remarkably well...



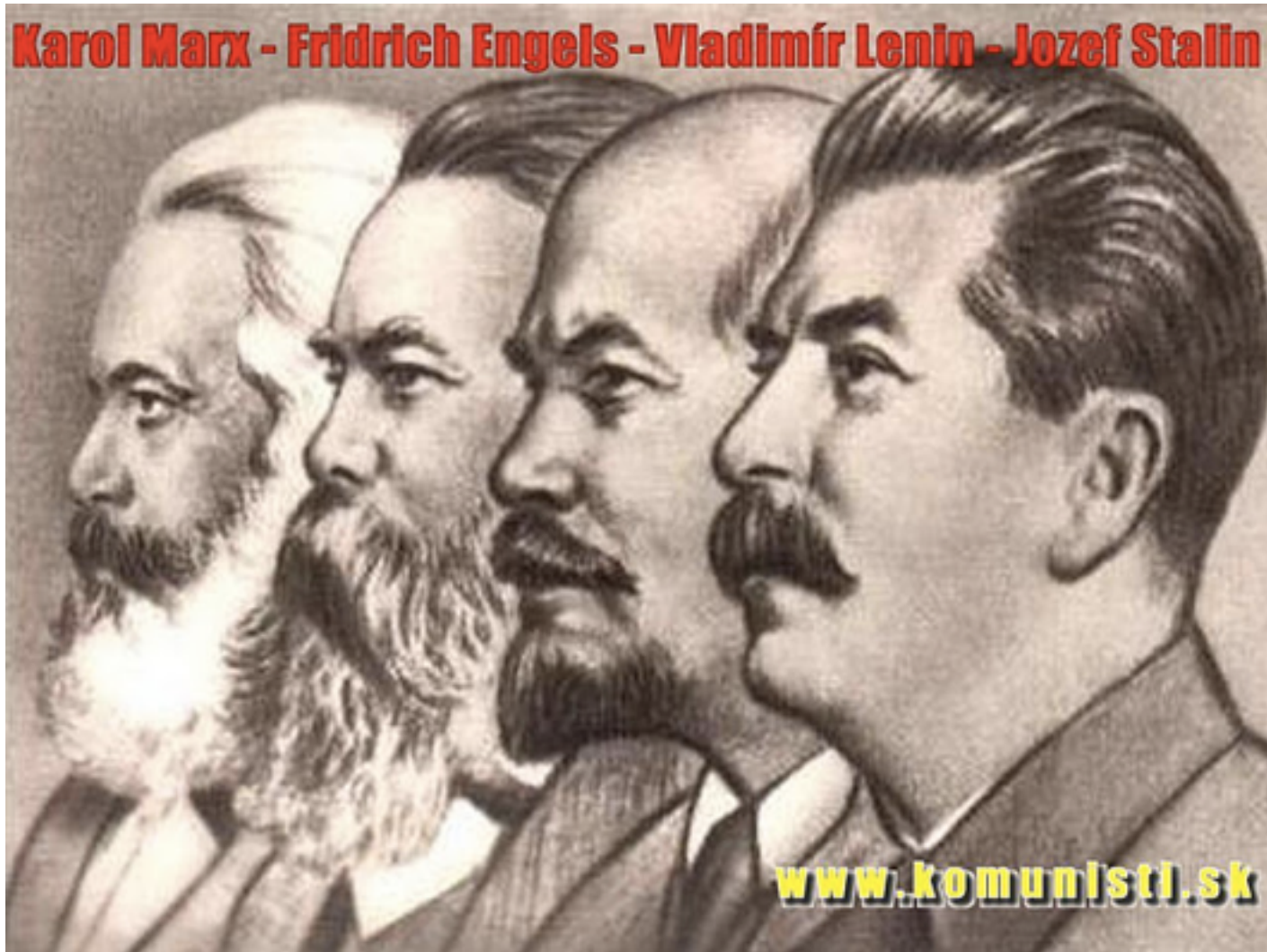
Our Task This Semester

- How is it that markets work so well?
- What can make them fail to work well?
- What can we do about it when they do fail us?
- What support from other pieces of society does a market—or perhaps we should say a mixed—economy really need?
- Are we really sure that markets work well?



How Remarkably?: The High Stalinist Experiment

Karol Marx - Fridrich Engels - Vladimír Lenin - Jozef Stalin



www.komunisti.sk

How Much Does Market Organization Matter?

- High Stalinist central planning
 - Marx's suspicion of markets as surplus-extraction devices
 - Hence, the communists said, we won't have any
 - We will reproduce the Rathenau-Ludendorff World War I Imperial German war economy
 - Communes, economies of scale, GOSPLAN, etc.
- Effect: you throw away a five-fold amplification of productivity by eschewing the market



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%

Greg Clark: Direct Estimates of Long-Run Real Wage Trends

- Greg Clark's numbers on what monks paid their construction workers, and what bread and other staples cost...
- Austan Goolsbee: It took 30 hours for an American laborer in 1850 to buy a bushel of corn. It takes 12 minutes today.
- Plus new goods and new types of goods: solid things, energy-manipulating things, information, and communication...

Figure 1: Real Wages of Construction Workers in England as Estimated by Greg Clark, 1200-Present



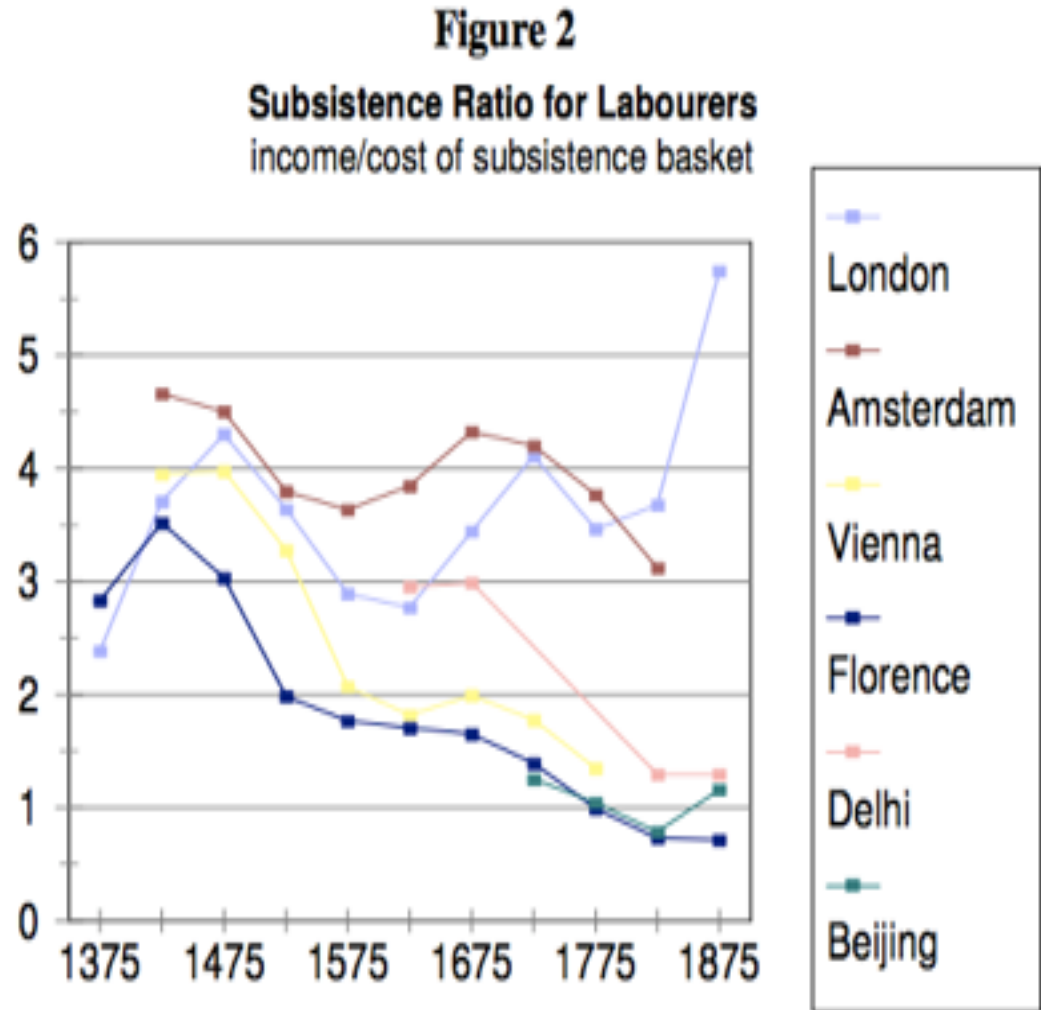
Source: Gregory Clark (2007), A Farewell to Alms; A Brief Economic History of the World (Princeton: 0691121354).

Rick Steckel's Numbers on Old World Heights

- “In nineteenth century Sweden, for example, average height was three to eight centimeters greater in rural areas compared with Stockholm, depending upon the time period and rural area (Sandberg and Steckel, 1988)....
- “In late eighteenth-century England, for example, the average heights at age 14 of poor boys admitted to the Marine Society were 20 centimeters below those of upper-class boys who attended the elite academy at Sandhurst (Floud, Wachter, and Gregory, 1990). During the same era, the difference in average height between the rich and the poor in the United States was roughly 3 centimeters (Margo and Steckel, 1982).”

Robert Allen's Numbers for World Cities

- This is a “subsistence basket” for one adult male...
- Unskilled urban laborers...
- How would one go about thinking of how representative of the population in general such numbers are?



A Malthusian Economy

- We are not terribly unhappy with our global estimates of world population.
- At what rate should a nutritionally-unstressed, pre-artificial birth control population grow?
- What is keeping the population growth rate down?

Year	Population (Millions)	Population Annual Growth Rate
-8000	5	
-1000	50	0.03%
0	170	0.12%
1500	500	0.07%
1800	750	0.14%
1900	1500	0.69%
2000	6200	1.42%
2015	7400	1.18%

A Malthusian Economy II

- Guessing at pre-industrial real income levels.
- But what do these mean? Not just new goods but new types of goods.
- It took 30 hours for an American male northern worker in 1850 to earn enough to buy a bushel of corn
- It takes 12 minutes now

In the Shadow of Malthus

Year	Population (Millions)	GDP per Capita (\$2015)	Total World GDP (\$2015 Billions)
-8000	5	\$750	\$4
-1000	50	\$750	\$38
0	170	\$750	\$128
1500	500	\$750	\$375
1800	750	\$1000	\$750
1900	1500	\$2000	\$3000
2000	6200	\$7700	\$47740
2015	7400	\$10000	\$74000

Thinking Like an Economist

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Two Basic Principles of Economics

- **The Scarcity (or No-Free-Lunch) Principle:** We have needs, and wants that are potentially boundless. But the resources available to us are limited. Choices are inevitable.
- **The Cost-Benefit Principle:** Don't do stupid stuff—do only stuff that makes sense, that leaves you better off.
 - Calculate costs and benefits sensibly!
 - Do not anchor, consider absolute magnitudes, don't forget implicit costs, optionality, do forget sunk costs, think at the margin
 - Is this cost-benefit principle positive—how people behave—or normative—how people ought to behave?

Four More Principles of Economics

- **The Incentive Principle:** “It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest...”
- **The Specialization Principle:** Practice makes perfect, or at least better. A society of generalists will tend to be a poor society.
- **Win-Win Exchange:** In a society of specialists, all parties benefit from *informed* trade.
- **Comparative Advantage:** Less productive than everyone else at making everything? You should still specialize at what you do *relatively* best—and trade. More productive than everyone else at making everything? You still benefit by specializing at your *comparative* advantage—and trading.

Principles: Individuals

- Principles of individual decision-making:
 - People must make choices because resources are scarce
 - What if resources aren't scarce? We'll focus our attention on an area of life in which they are scarce!
 - The opportunity cost of an item is its *true* cost
 - “How much” decisions inevitably involve making decisions *at the margin*
 - People *usually* respond to *material* incentives—exploiting opportunities to make themselves better off
 - “[hu]man has almost constant occasion for the help of his [or her] brethren, and it is in vain... to expect it from their benevolence only”

Principles: Interactions

- Principles of social interactions:
 - There are gains from trade
 - “In civilized society [man] stands at all times in need of the cooperation and assistance of great multitudes”
 - “[Man’s] whole life is scarce sufficient to gain the friendship of a few persons”
 - “A spaniel endeavours by a thousand attractions to engage the attention of its master.... [Man] has not time, however, to do this upon every occasion”
 - Resources ought to be used as “efficiently” as possible
 - Markets move toward “equilibrium”
 - Market equilibrium usually (?) leads to “efficiency”
 - Whenever a market is not achieving “efficiency”, government intervention can improve society’s welfare

Principles: Emergent Macro Difficulties

- Principles of macroeconomics:
 - One person's spending is another person's income
 - Overall spending sometimes gets out of line with the economy's productive capacity
 - Government policies can change spending
- But we won't talk about these until nearly spring break.
 - For the next two months we will assume that people in aggregate want to spend their incomes today
 - Those who want to spend less than their income are balanced by those who want to spend more

The Many Things that the Market System Gets Us

- People can “specialize” in what they are most productive doing
- People can become more productive
- People can trade via this institution called “market”
- Market exchange is win-win
 - But relative to what baseline?
- Market exchange maximizes wealth
 - As long as commodities are excludible, rival, known, and internal
- Distribution?



Remember: Government *Creates* the Market System

- All this “laissez faire vs. government” ideology is greatly oversold...
- Economists start with an autarchic baseline, and then move to a trading-what-you-made-with-your-own-hands benchmark, and then start talking about government
- Money and trust
 - “Thick-tie” exchanges
 - “Thin-tie” exchanges
 - Weights and measures
- Property rights
- Contract enforcement
- Threats to property, contract, and (arms-length) exchange:
 - Positive and negative affective ties
 - Roving bandits
 - Local notables
 - Government’s own functionaries
- The so-called “night watchman” state is a mighty instrumentality indeed...

Do I Need to Go Through the Appendix to Ch 1?

- The Alfred Marshall paradigm: words, graphs, equations.
- The Samuelson post-World War II MIT experiment.
- How well has this served us?
- You should be able to handle this mode of analysis —you should be able to move well enough between verbal chains of causation and analysis, equations, and graphs via analytic geometry.
 - If not? We will find out quickly, and double back