

No — as long as you do not expect soothsaying, it is remarkably successful

If you asked a group of economists to predict my response to this question, the vast majority would say I would reply, "no", writes **Chris Giles**. An analysis of my probable motivations and my constraints working in the rigorous Financial Times newsroom would be sufficient evidence for most. They would have had no

Head to Head Economic forecasting + Add to myFT

Has economics failed?

Two experts debate the future of the discipline



Tom Clark and Chris Giles APRIL 24, 2018 275

Yes — outdated frameworks still inform policy prescriptions

Think again. Think Prospect

POLITICS ECONOMICS & FINANCE WORLD ARTS & BOOKS LIFE

HOME > MAGAZINE

Rip it up and start again: the case for a new economics

Until we ditch the old textbook, we'll never face up to the challenges of the modern world—or move beyond neoliberalism

by Howard Reed / April 13, 2018 / Leave a comment
Published in May 2018 issue of Prospect Magazine



HOME > ECONOMICS & FINANCE

In defence of the economists

Our field is not perfect. But the idea that it is so tainted we must "rip it up and start again" isn't just pessimistic—it is based on inaccuracies

by Diane Coyle / April 13, 2018 / Leave a comment

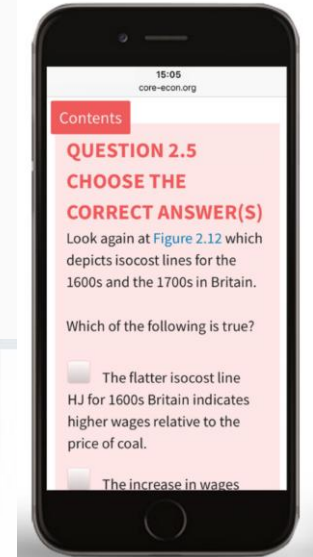


Distributional effects of tax and benefit the UK (compared to income-upr

Free online,
go to www.core-econ.org



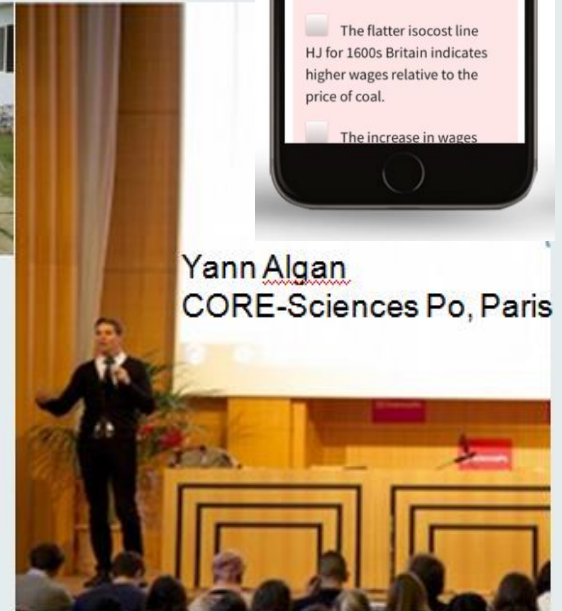
Belinda Archibong, CORE-USA
Barnard College, Columbia University



The Econ 101 paradigm is broken – what is the alternative?



Azim Premji
University,
Bangalore



Yann Algan
CORE-Sciences Po, Paris



Antonio Cabrales CORE-UCL

Wendy Carlin, UCL and CORE
Slovak Economic Association Meeting (SEAM) 2018
Keynote Lecture
September 2018

Economics teaching in trouble

Natalie Grisales
Student at
Universidad de
los Andes



I hoped economics would give me a way to describe and predict human behaviour through mathematical tools; ... after semesters of study, **I had mathematical tools; but** all the **people** whose behaviour I wanted to study **had disappeared from the scene**

Refik Erzan
Professor at
Boğaziçi
University,
Istanbul



When **economics students** are asked about the economy, their **reasoning is no different from the wisdom of taxi drivers**, and sometimes a bit less well informed

Tim Harford
Economics
journalist
BBC, FT



What **we teach in economics** today determines what people think tomorrow, it's the analysis of tomorrow, it's the **policy advice of tomorrow**, it's the political discourse of tomorrow. We **can't just ignore this** and think it's just a little academic game. It matters.

Economics teaching in trouble

Students

Economics is hard, boring and unrelated to the questions we want to answer

Lecturers

Teaching a standard principles course is easy but student engagement is poor and the content does not reflect advances in economics and the way we do research

Employers/
Public policy

Economics graduates are technically competent but unable to relate their knowledge to other team members or apply it to problems

CORE: A global collaboration of researchers



Yann Algan
Sciences Po, Paris



Tim Besley
LSE



Samuel Bowles
Santa Fe Institute



Antonio Cabrales
UCL



Juan Camilo Cárdenas
Universidad de los Andes



Wendy Carlin
UCL



Diane Coyle
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Marion Dumas
Santa Fe Institute; LSE



Georg von Graevenitz
Queen Mary University of
London



Cameron Hepburn
University of Oxford



Daniel Hojman
University of Chile



David Hope
King's College London



Arjun Jayadev
Azim Premji University



Suresh Naidu
Columbia University



Robin Naylor
University of Warwick

CORE: A global collaboration of researchers



Kevin O'Rourke
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Begüm Özkaynak
Boğaziçi University



Malcolm Pemberton
UCL



Paul Segal
King's College London



Nicholas Rau
UCL



Rajiv Sethi
Barnard College, Columbia University



Margaret Stevens
University of Oxford



Alex Teytelboym
University of Oxford

- **Researchers and teachers from around the world** – from Colombia to Bangalore, from Sciences Po to Columbia University
- United by the **goal** of creating high quality open access resources to **bring to students the best of economics**
- Enabling them to engage in **evaluation and debates** on the pressing **public policy issues** of today

Teaching the tools of economics – motivated & disciplined by facts

In this video, Nobel laureate James Heckman and Thomas Piketty explain how collecting data has been fundamental to their work on inequality and the policies to reduce it.

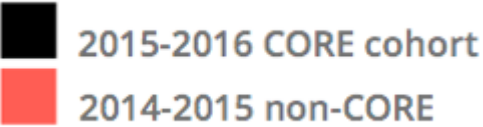


Does it work? UCL replaced 'ECON101' by CORE for all BSc Econ students in 2014

Examination results in 2016 of the first CORE cohort in their conventional **second year** intermediate micro and macro exams:

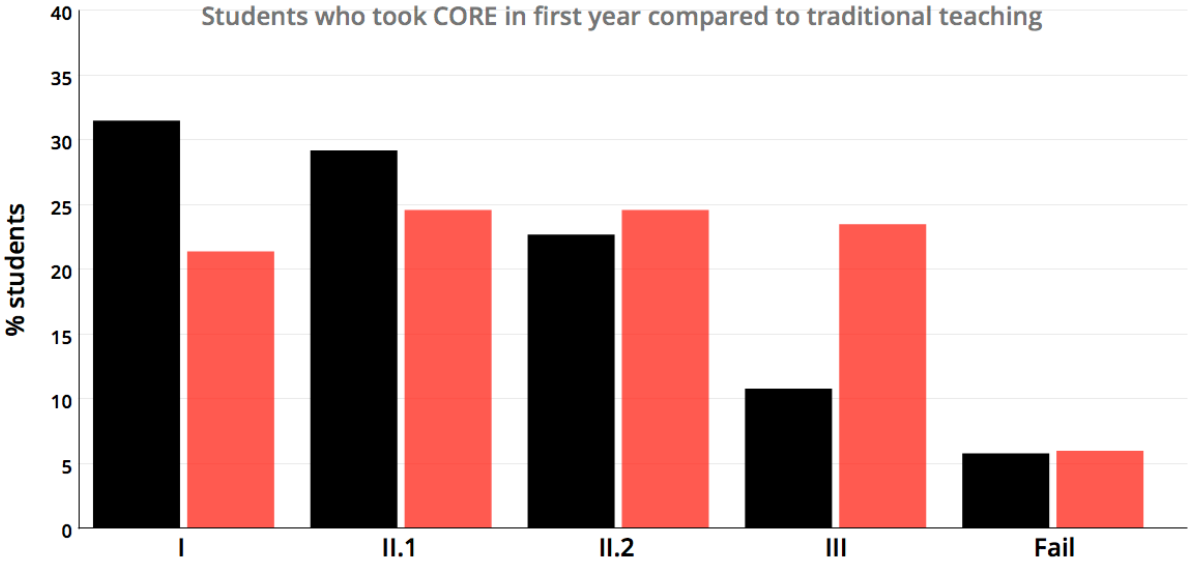
Comparison of first CORE cohort (n=269) with last non-CORE cohort (n=288)

Students who had studied CORE (the black bars) performed better in intermediate micro & macro



UCL Intermediate Microeconomics

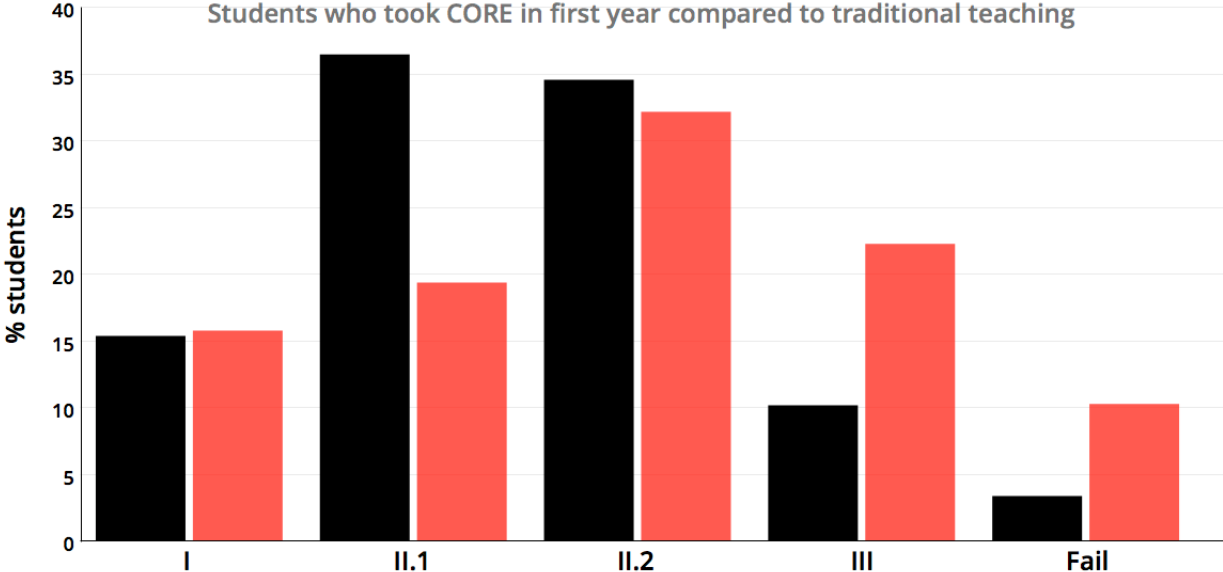
Students who took CORE in first year compared to traditional teaching



First class (distinction)Fail

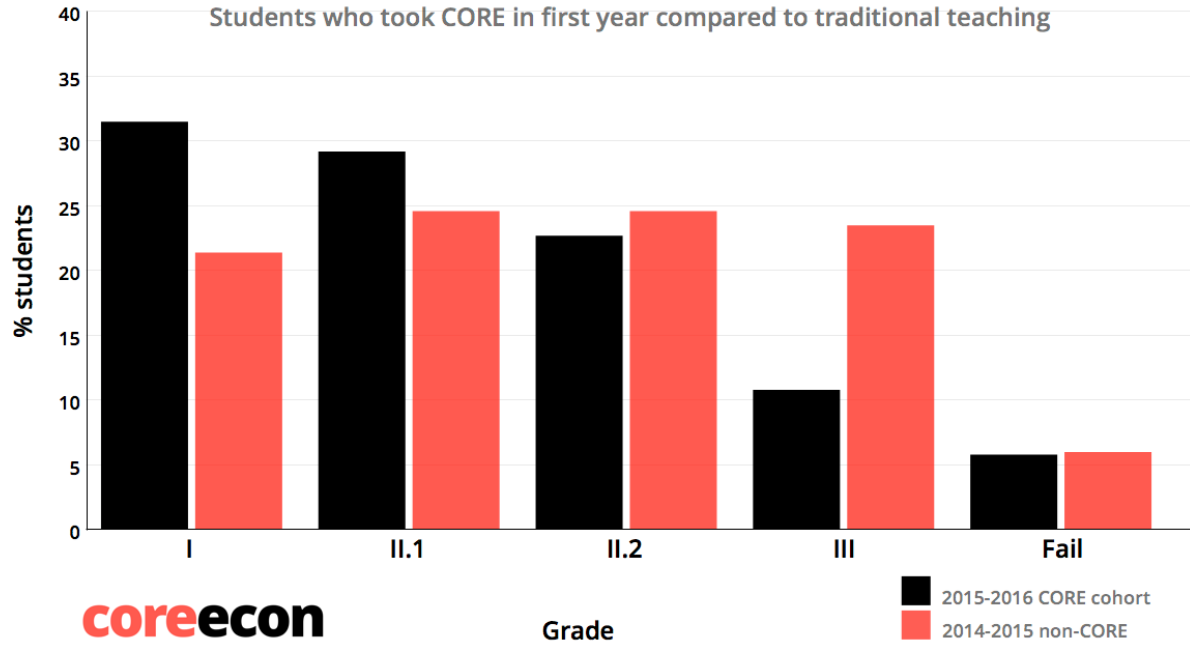
UCL Intermediate Macroeconomics

Students who took CORE in first year compared to traditional teaching

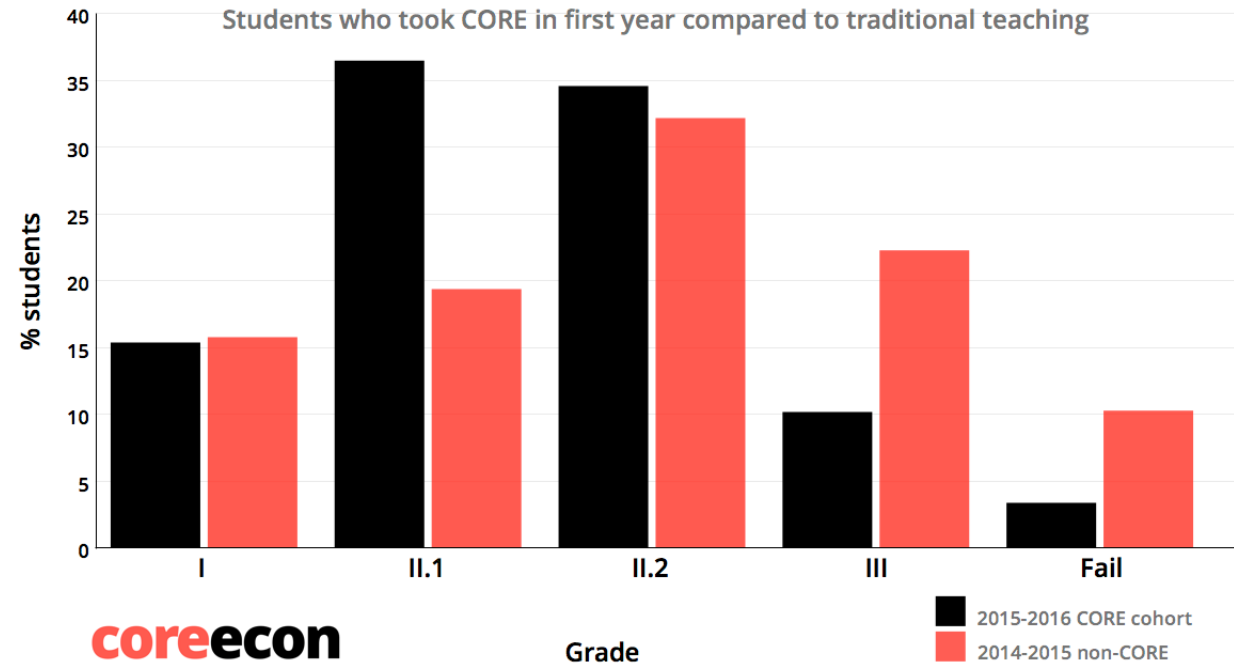


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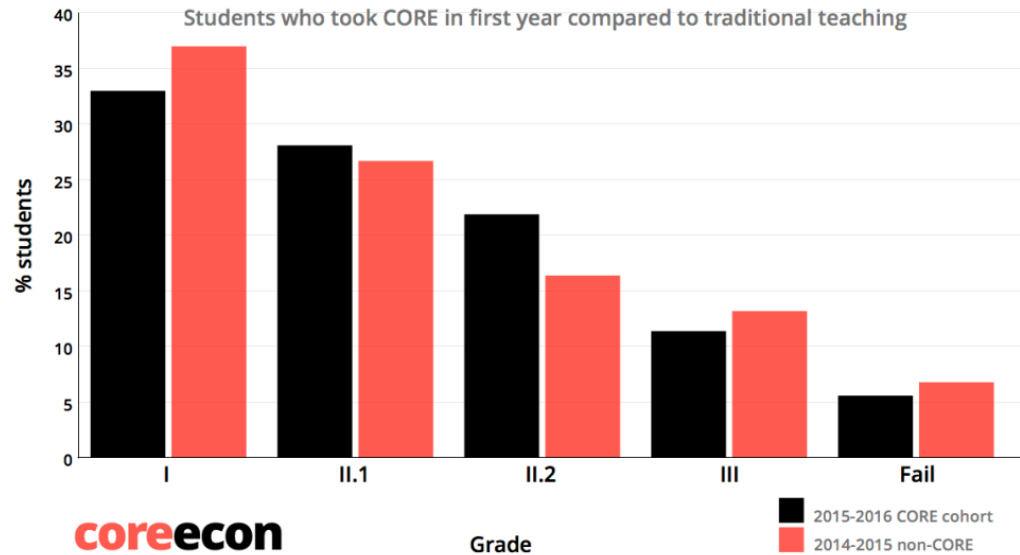
UCL Intermediate Microeconomics



UCL Intermediate Macroeconomics

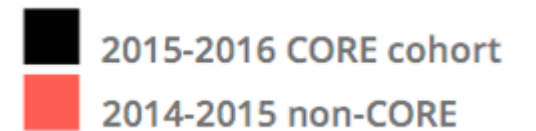


UCL Intermediate Econometrics



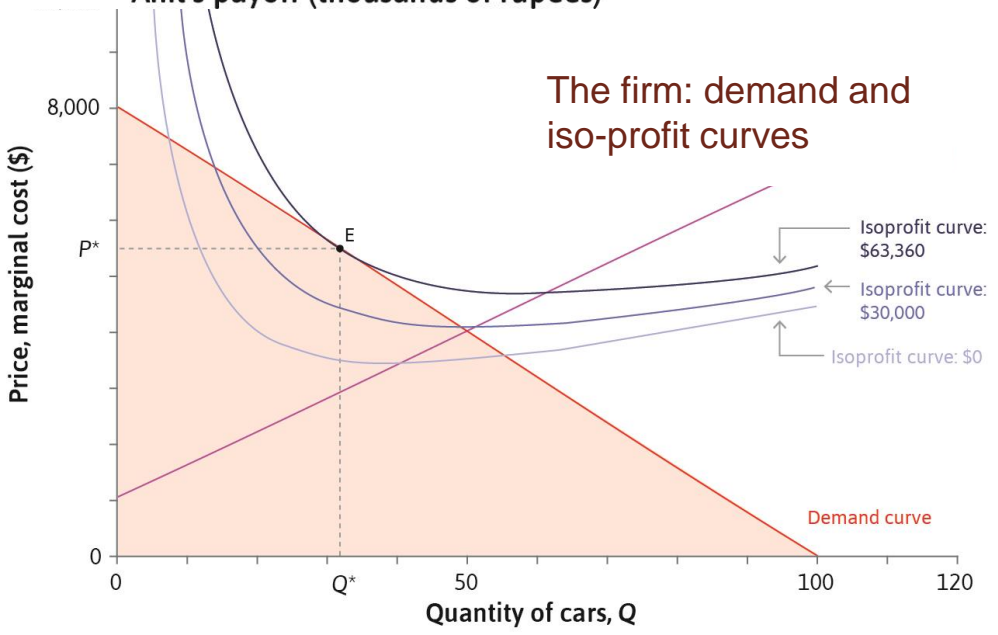
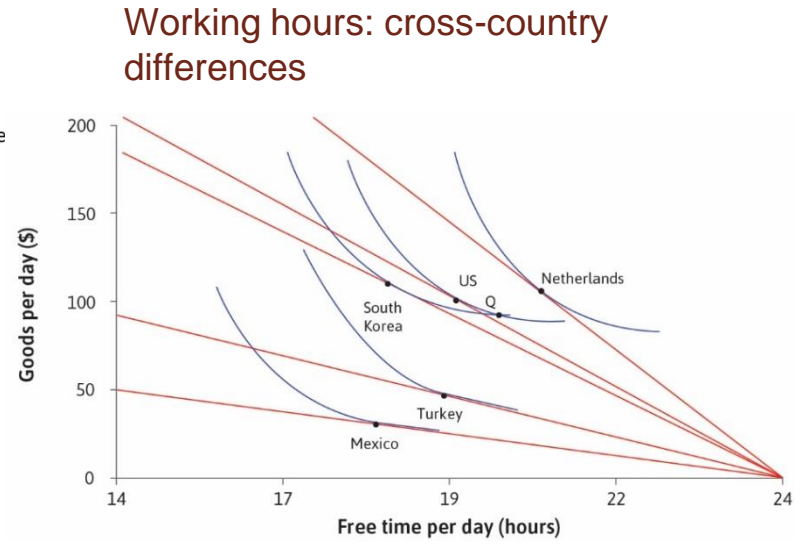
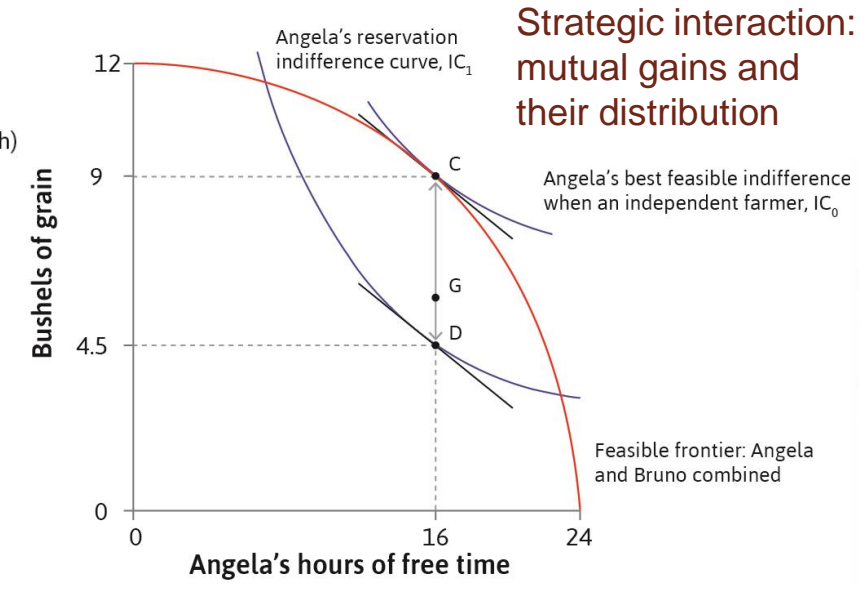
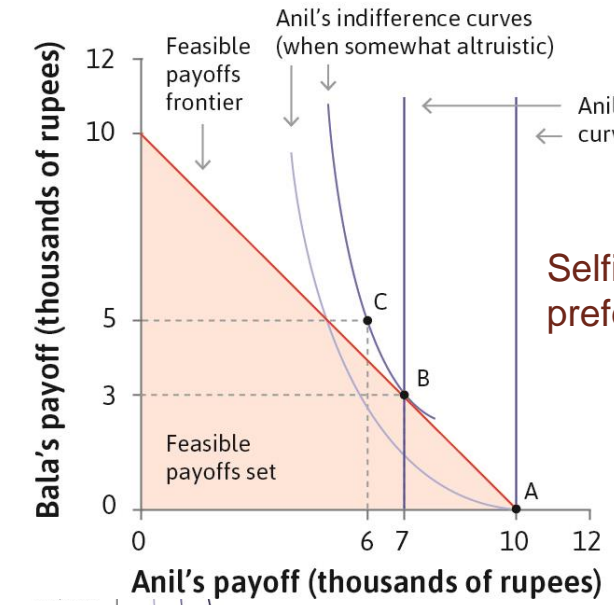
Just better students that year?

What could explain this?



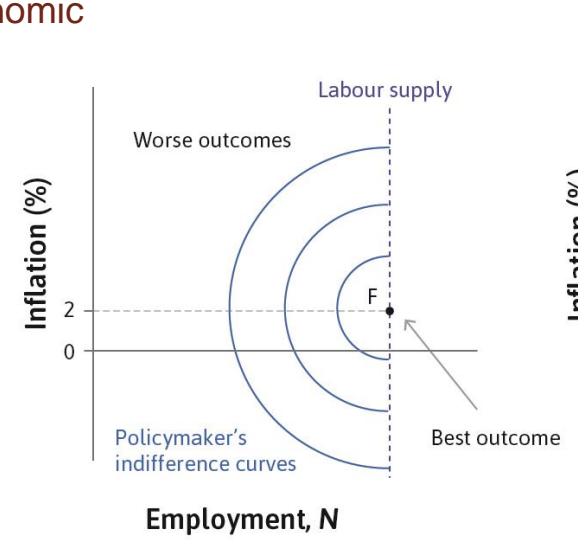
Why does it work? Teaching the tools of economics – feasible sets and preferences

– motivated by and applied to real problems in the world

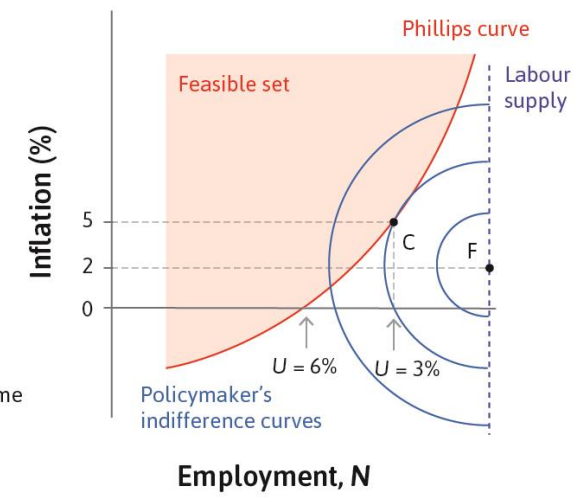


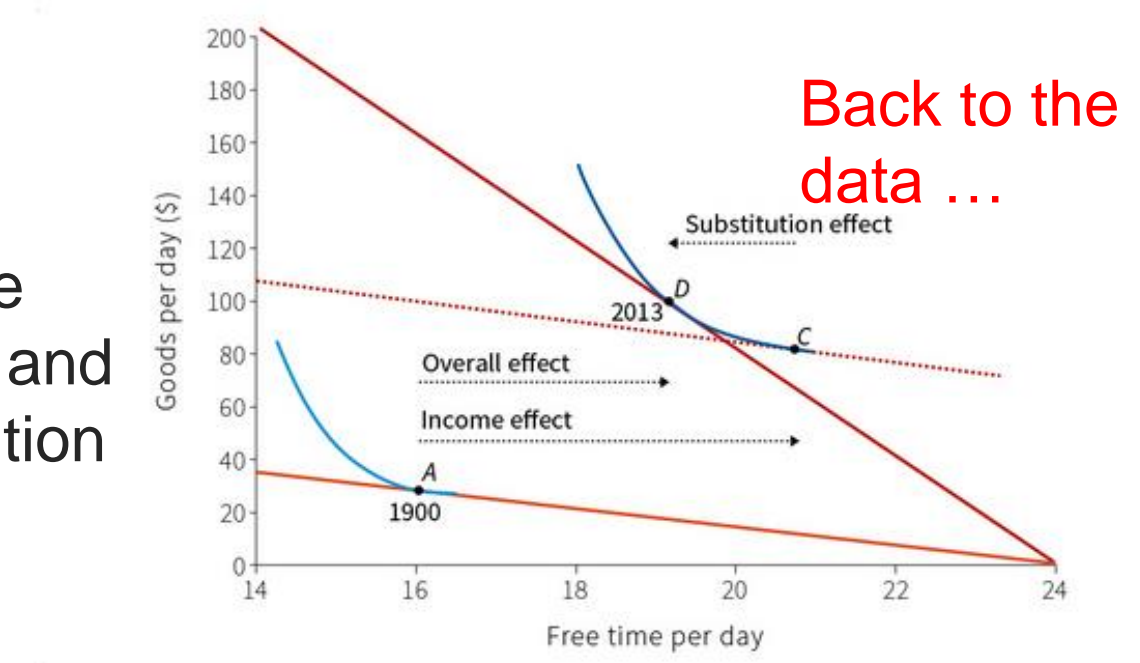
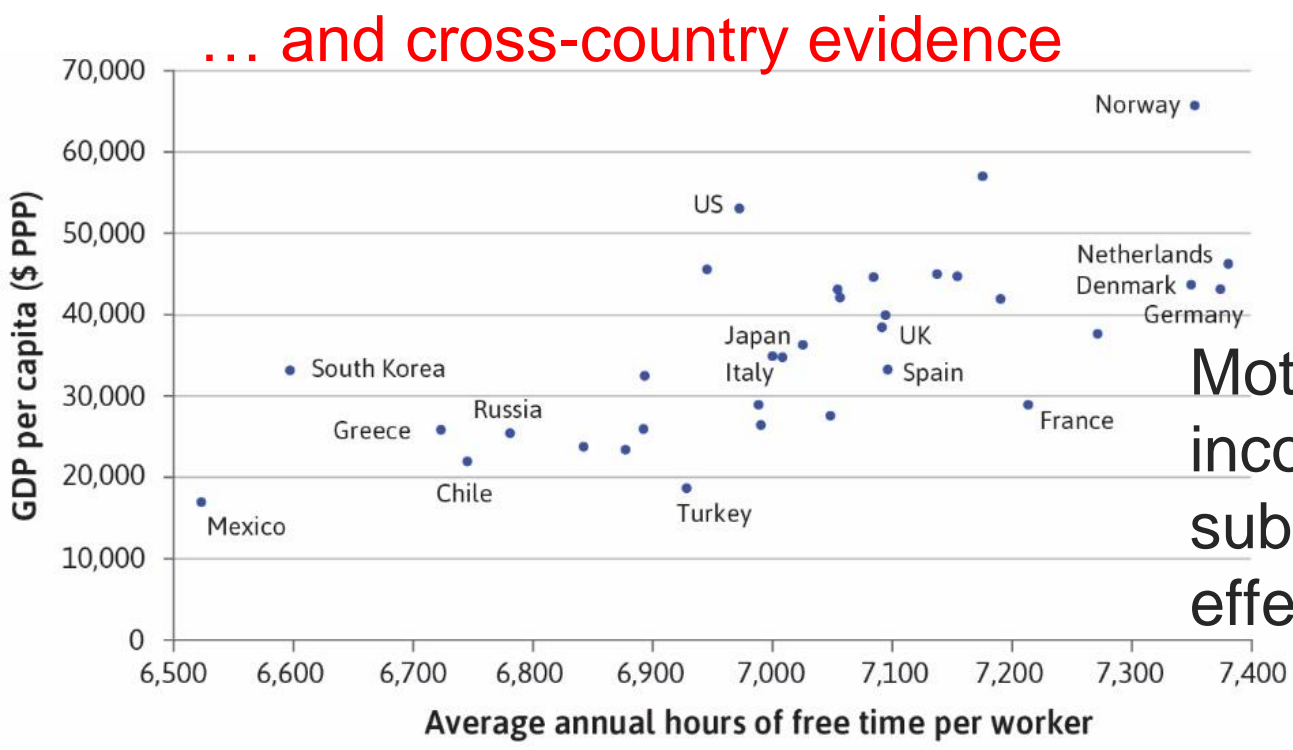
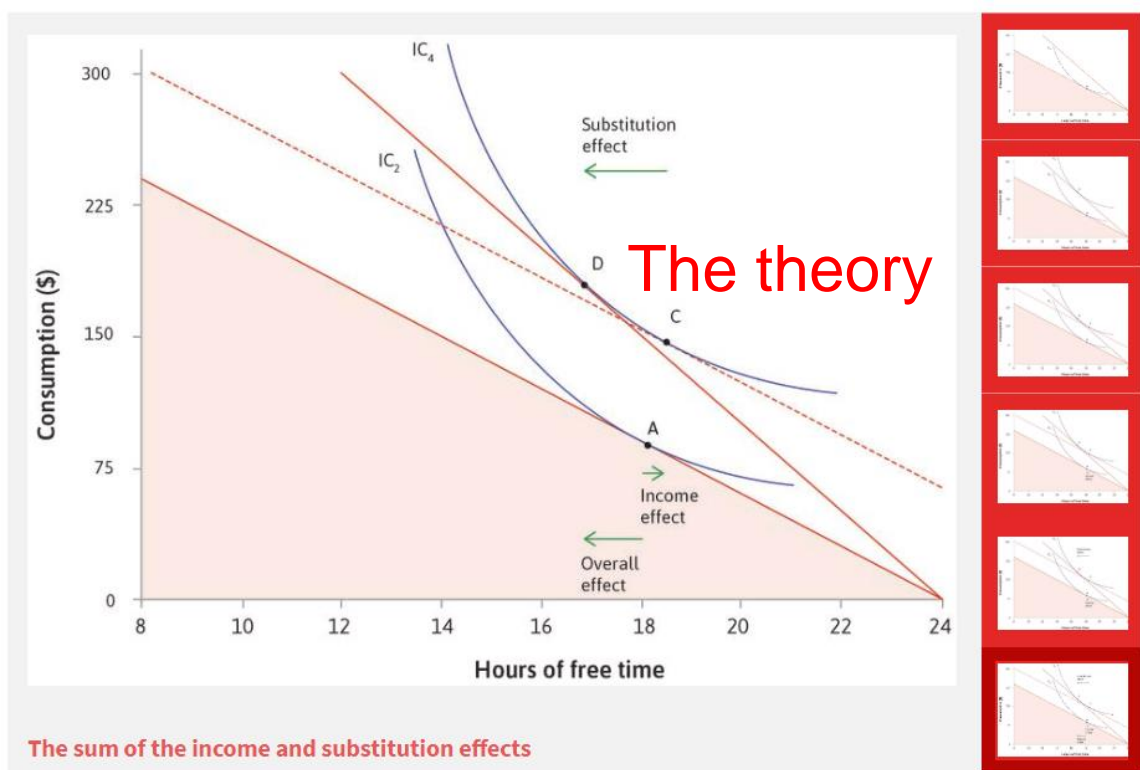
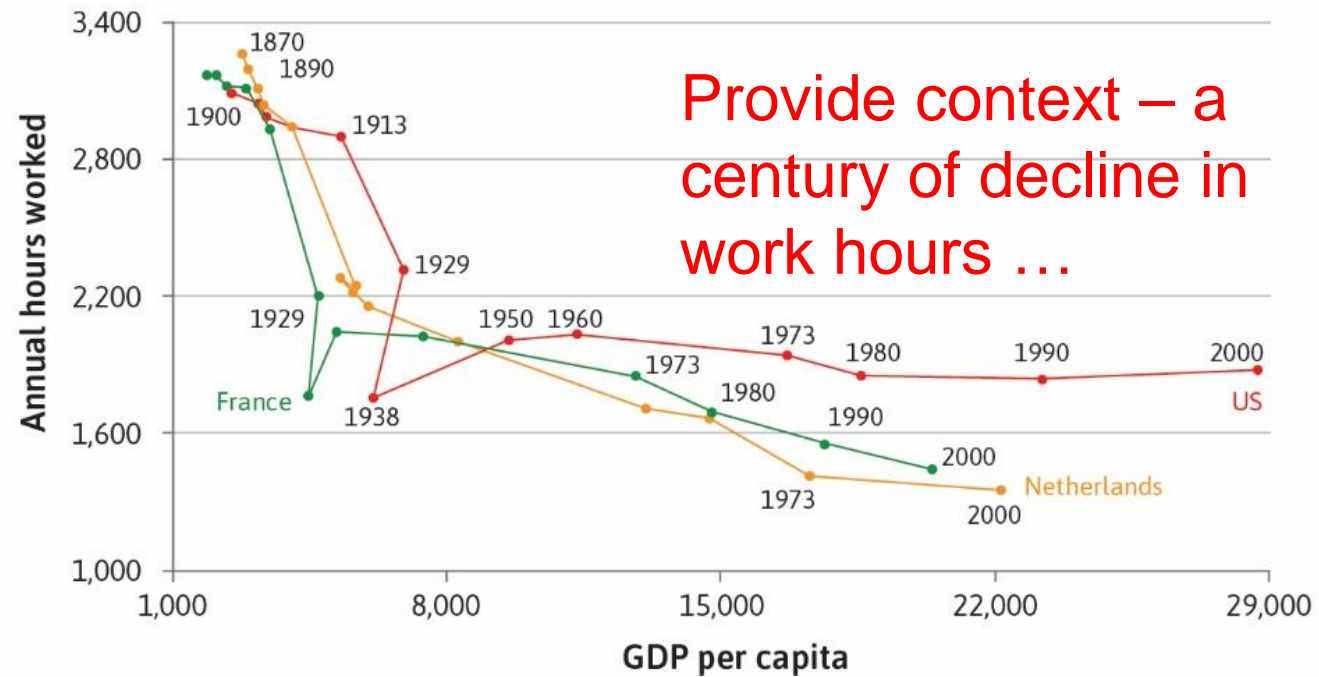
The macroeconomic policy maker

The policymakers' preferences



The policymakers' preferences and the Phillips curve trade-off

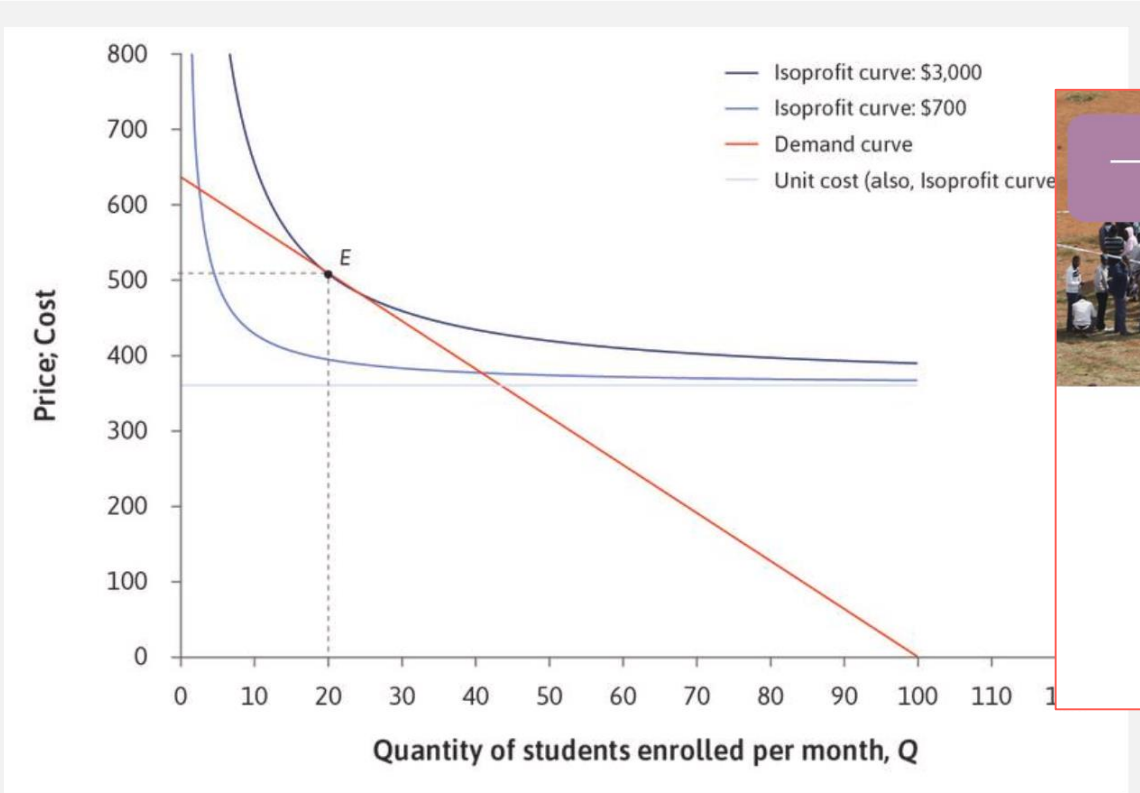




Learn tools that can be applied to different problems in the real world

The profit maximizing firm sets the price

The rent-maximizing elite sets the tax



Future duration of the governing elite's time in office, D (years)

Figure 22.9 Choice of taxes under less and more competitive conditions.

Maximizing profit at E

The owner reaches the highest possible isoprofit curve while remaining in the feasible set by choosing point E, where the demand curve is tangent to an isoprofit curve. She should choose $P = \$510$, selling $Q = 20$ courses.

Figure 7.7 The profit-maximizing choice of price and quantity for LP Spanish-language

Why does it work? Developing mathematical understanding in the context of economic problems

LEIBNIZ

4.4.1 Altruistic preferences: Finding the optimal distribution

Anil has won the lottery and must decide what to do with his 10,000 rupees. He has altruistic preferences: while he is pleased to receive the money, he also cares about his neighbour Bala who did not win anything. We can use the technique of constrained optimization to model his decision.

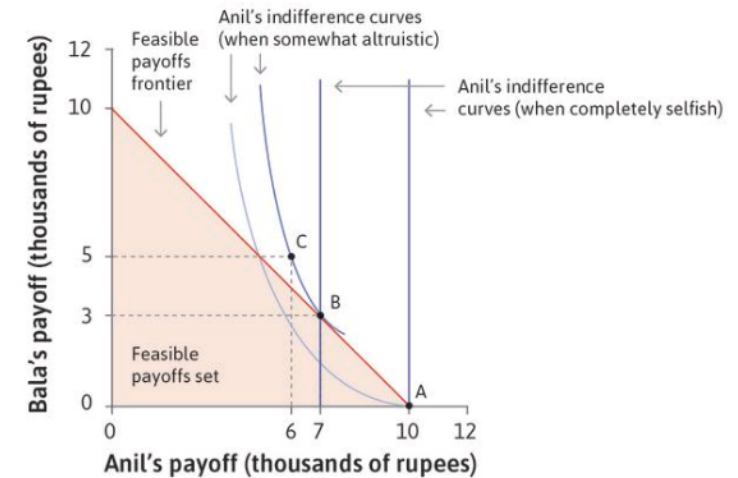


Figure 1 Anil's optimal allocation when he is altruistic.

If we knew Anil's preferences (his utility function), we could solve the constrained optimization problem to determine the point B precisely. Let's suppose he has a Cobb-Douglas utility function of the same form as Alexei's in Leibniz 3.5.1:

$$U(x, y) = x^\alpha y^\beta$$

where α and β are positive constants. Anil's marginal utilities are found as usual by partial differentiation:

$$\frac{\partial U}{\partial x} = \alpha x^{\alpha-1} y^\beta = \frac{\alpha U}{x}, \quad \frac{\partial U}{\partial y} = \beta x^\alpha y^{\beta-1} = \frac{\beta U}{y}$$

His marginal rate of substitution (the absolute value of the slope of the indifference

What do economists do?



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Young economist talking to colleague and explaining financial papers

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What do economists do? Introducing students to what we do



Esther Duflo: Representation for women in India

Esther Duflo: Representation for women in India



Petra Moser: How copyright improved Italian opera

Petra Moser: How copyright improved Italian opera

QUESTION 3.1 CHOOSE THE CORRECT ANSWER(S)

According to the 'Economist in action' video featuring Esther Duflo:

- The reform of the panchayat (local council) was a natural experiment that enabled economists to attribute the changes in public goods investment to having women representation in the council.
- Duflo learned about villagers' attitudes towards women as policymakers by asking them directly.
- A medium-term effect of the local council reform is that career aspirations of girls changed.
- A long-term effect of the local council reform is that girls were less likely to drop out of middle school.

Check my answers

EXERCISE 3.9 EFFECTIVE POLICYMAKING FOR INTELLECTUAL PROPERTY RIGHTS

Watch the 'Economist in action' video, in which Petra Moser discusses copyright protection for nineteenth-century Italian operas.

1. Outline Petra Moser's research question, and her approach to answering it.
2. What were Petra Moser's findings about patents and copyrights?
3. What factors should governments consider when deciding on the effective time period of IPR protection laws, such as patents and copyrights?

EXERCISE 17.9 BANKING REGULATIONS CAN HELP BRING ON FINANCIAL CRISES

An 'Economist in action' video shows Anat Admati, an economist, explaining the problems with the regulation of the banking system.



Anat Admati: What's wrong with banking (and what to do about it).

1. Using housing prices as an example, explain the upsides and downsides of leverage.
2. According to the video, what is the key difference between banks and other corporations, and why is this dangerous for the banking system?
3. What are some factors that contribute to the fragility and riskiness of the banking system, and how can we prevent future financial crises from occurring?

What is the most pressing issue that economists today should address?



Victoria University of
Wellington New Zealand

What is the most pressing issue that economists today should address?

Problems, paradigms and texts

- A paradigm according to Kuhn is what is taught to good undergraduates
- It emerges when researchers have stopped using the previous benchmark model
- New real-world problems sometimes instigate new paradigms in economics
 - e.g. the Great Depression and the “Keynesian revolution”
- And these new paradigms are eventually codified in a new textbook.
 - e.g. the “Keynesian revolution” and Samuelson 1948
- Earlier paradigm setting texts: Marshall 1890, Mill 1848
- The basic content and method of the top intro economics textbooks has changed relatively little in the half century since Samuelson; the popular modern texts are very similar
- **CORE represents a new paradigm based on different first principles able to address today’s economic challenges.**

A paradigm in economics has to take a position on

- What the economy is
- What people are like
- How we interact in the economy

- The economic outcomes of these interactions
- How these are to be evaluated
- How they may be improved by public policy

A paradigm in economics has to take a position on

Benchmark

- What the economy is
- What people are like
- How we interact in the economy
- The economic outcomes of these interactions
- How these are to be evaluated
- How they may be improved by public policy

Econ 101

Static, self-contained system

Homo economicus

Perfectly competitive markets

Static and 'optimal'

Unexploited mutual gains

Limited to narrowly defined market failures

CORE, and contemporary economics

We'll fill in the right hand column. .. But first:

How would a benchmark model look if the course began a little differently from the usual?



UNIT 1

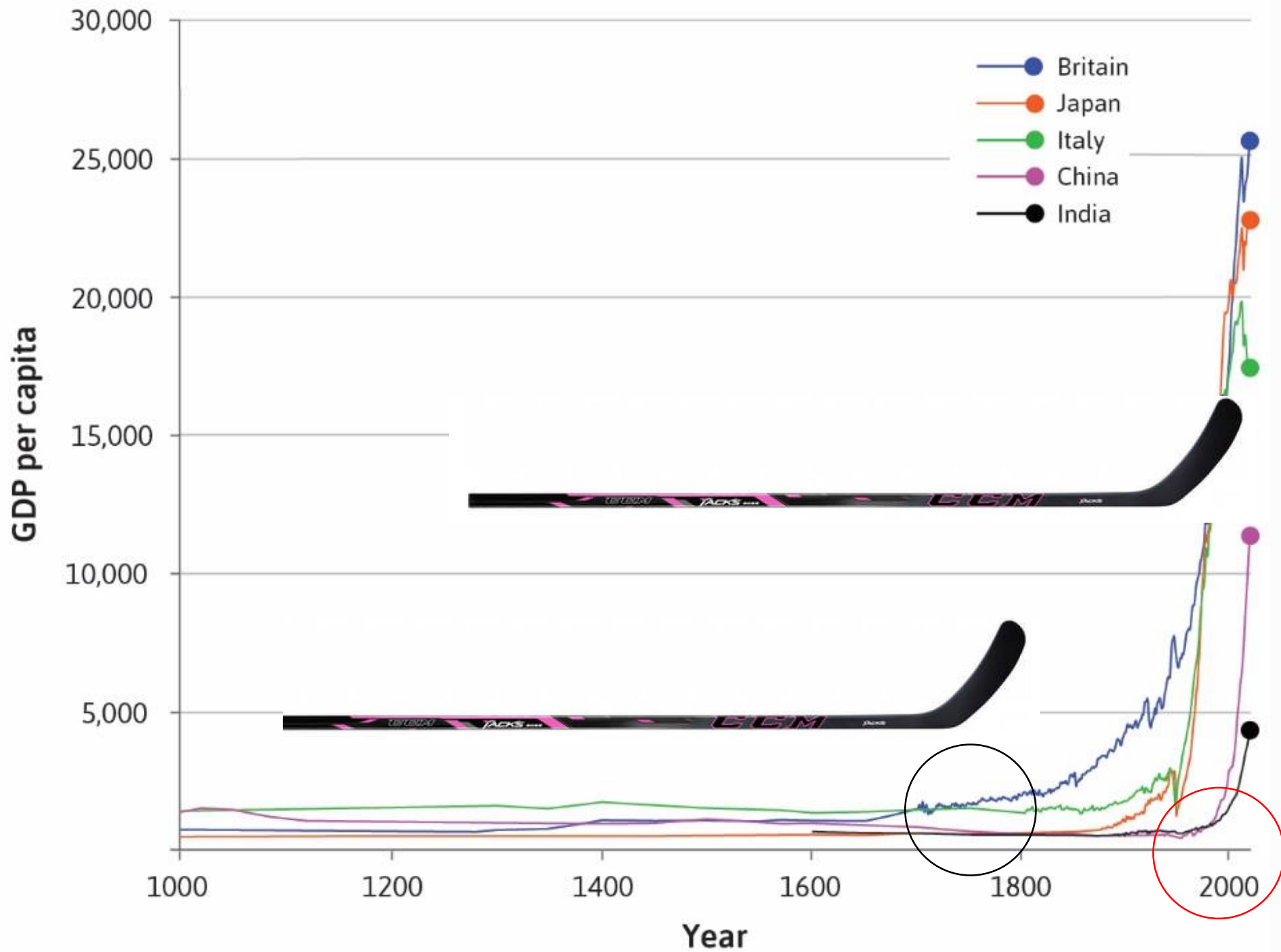
THE CAPITALIST REVOLUTION

How capitalism revolutionized the way we live, and how economics attempts to understand this and other economic systems

- Since the 1700s, increases in average living standards became a permanent feature of economic life in many countries.
- This was associated with the emergence of a new economic system called capitalism, in which private property, markets and firms play a major role.

– THEMES AND CAPSTONE UNITS

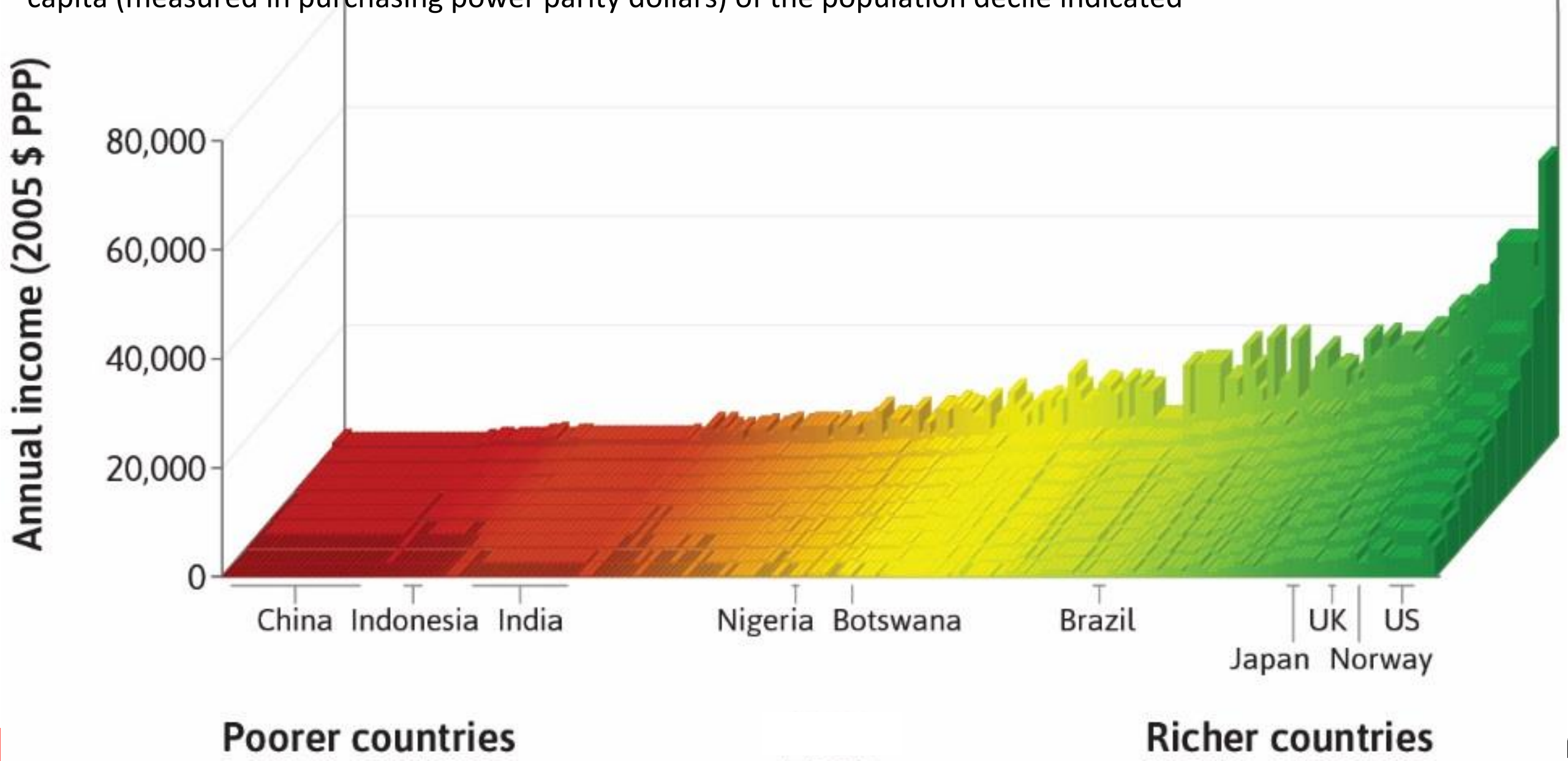
- History, instability, and growth
- Global economy
- Inequality
- Environment
- Innovation
- Politics and policy



One of the first figures the student sees in CORE (and can [manipulate](#))

The distribution of income in the world. Height of the bars is the gross domestic income per capita (measured in purchasing power parity dollars) of the population decile indicated

1980



1990

Annual income (2005 \$ PPP)

80,000
60,000
40,000
20,000
0

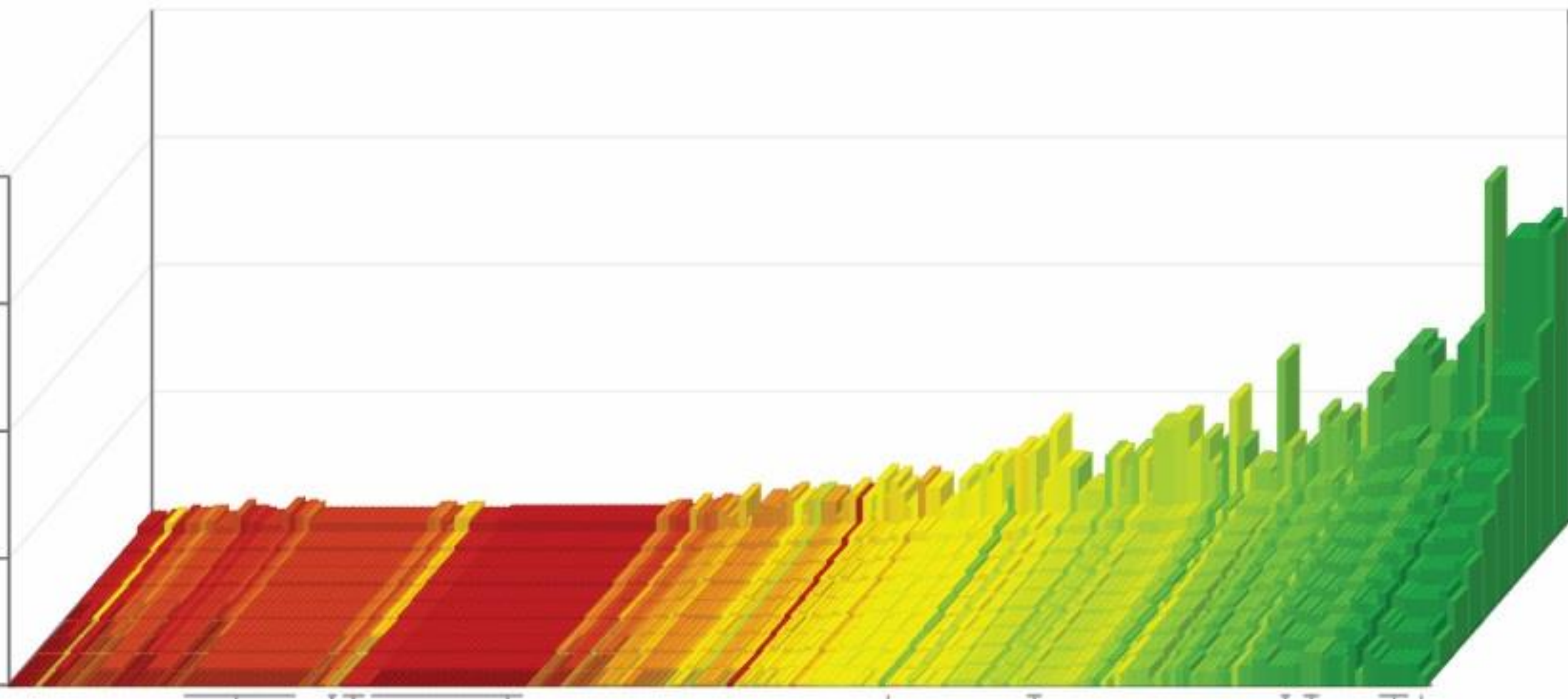
India
Nigeria
Indonesia
China

Botswana
Brazil

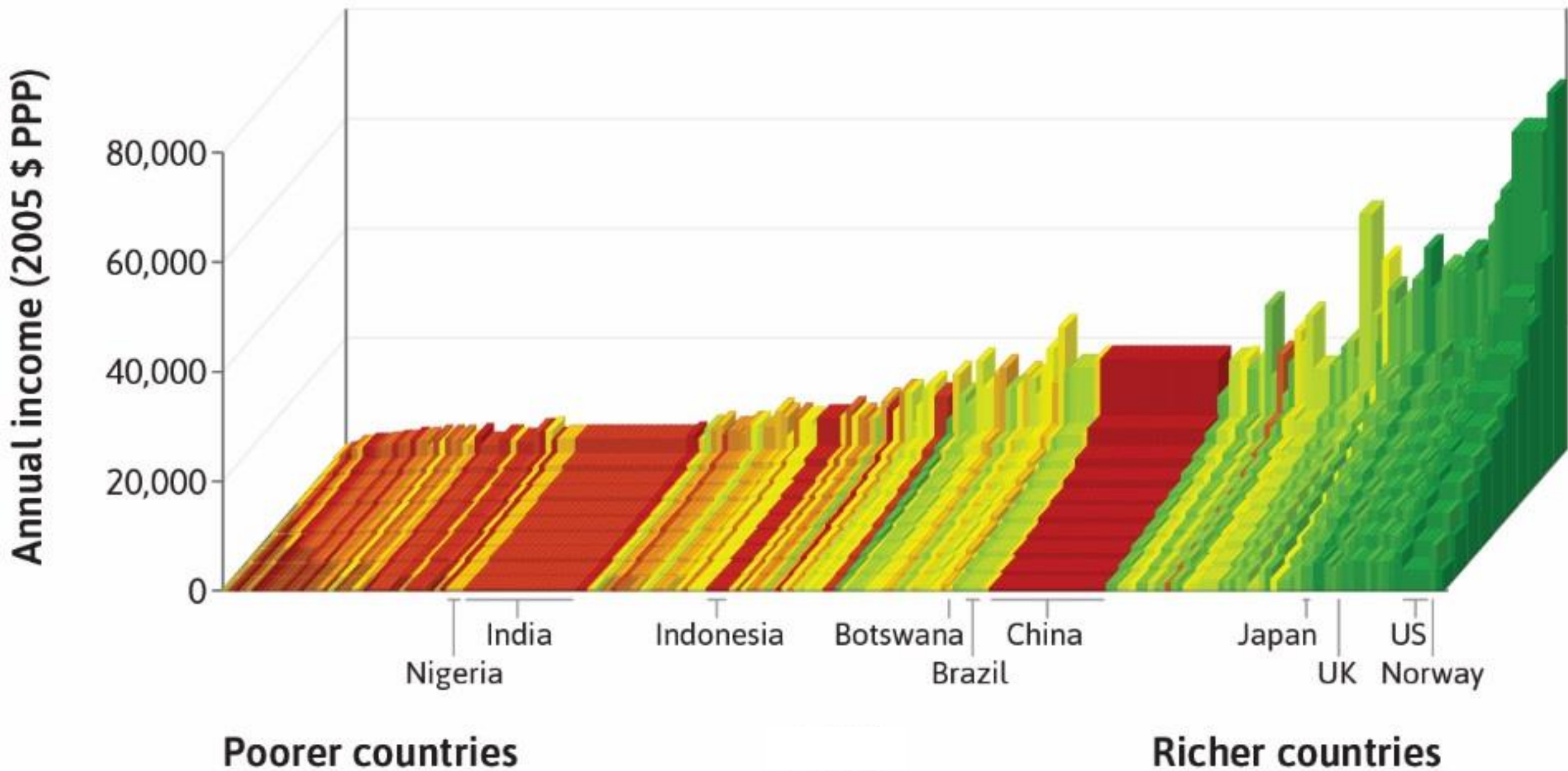
UK
Japan
US
Norway

Poorer countries

Richer countries



2014



If the new problems and questions are not an afterthought but at the front of the book, there will have to be some changes in the **rest** of the book... examples

Problems

- Wealth creation & growth
- Environmental problems
- Inequality
- Unemployment & fluctuations
- Instability

*Key concepts **new to Intro***

- Schumpeterian rents, disequilibrium
- Social interactions / other-regarding preferences
- Economic rents, bargaining power, institutions
- Incomplete contracts in labour & credit markets
- Prices as information & dynamics of price-setting

Motivating learning by complex problems, we focus on actors, stressing

- **Game theory** – Nash equilibrium, multiple equilibria
- **Principal agent models**
- **Price-making** and (economically productive) **rent seeking**
- Social preferences and **norms**
- Increasing returns, **positive feedbacks**
- **Dynamics**

This leads to a novel sequencing of the material taught ...

for example, teach game theory, social norms, institutions, and firms *before* markets

... and provides key foundations for understanding the **aggregate economy** by

- beginning with **heterogeneous agents** through a set of **principal-agent problems** and
- leading naturally to a model with **involuntary unemployment** and **fluctuations**, **endogenous money** and **bubbles**
- and where **inequality** is in the modelling framework's DNA

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Problems

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- Environmental problems
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UNIT 5

PROPERTY AND POWER: MUTUAL GAINS AND CONFLICT

Economic institutions are the rules of the game – who does what and who gets what on a pirate ship

HOW INSTITUTIONS INFLUENCE THE BALANCE OF POWER IN INTERACTIONS AMONG ECONOMIC ACTORS, AND HOW THIS AFFECTS THE FAIRNESS AND EFFICIENCY OF THE ALLOCATIONS THAT RESULT

- Technology, biology, economic institutions and people's preferences all matter as determinants of economic outcomes
- Interactions between economic actors can result in mutual gains, and also in conflicts over how the gains are distributed
- *Power* is the ability to do and get the things we want in opposition to others

THE ROVER'S ARTICLES

ARTICLE I

Every Man has a Vote in the Affairs of the Moment; has equal title to fresh Provisions...

ARTICLE III

No person to Game at Cards or Dice for Money.

ARTICLE IV

The Lights and Candles to be put out at eight a-Clock at Night; If any of the Crew after that Hour still remained enclined for drinking, they are to do so on the open Deck...

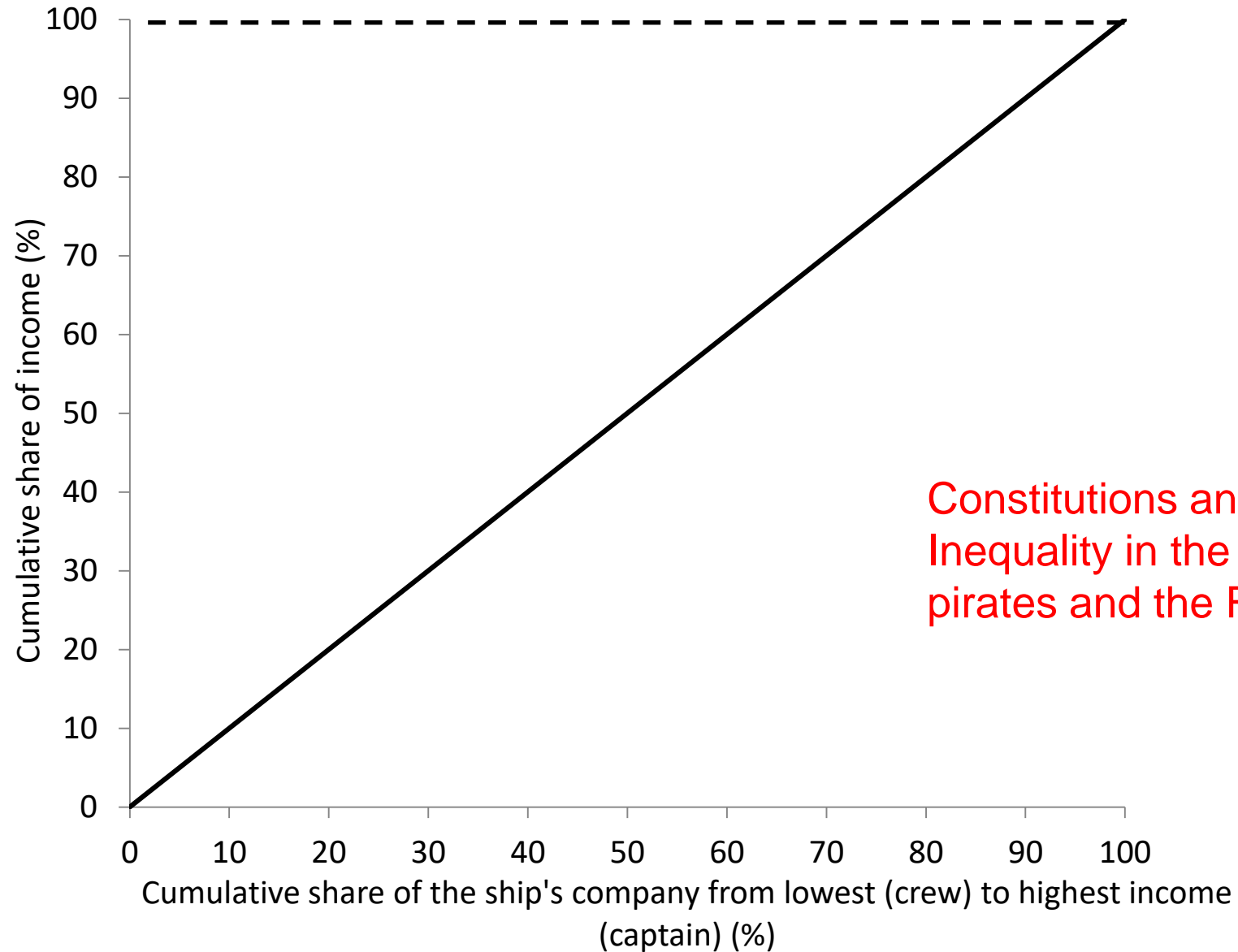
ARTICLE X

The Captain and Quarter Master to receive two Shares of a Prize (the booty from a captured ship); the Master, Boatswain, and Gunner one Share and a half, and other Officers one and a Quarter (everyone else to receive one share, called his Dividend.)

ARTICLE XI

The Musicians to have Rest on the Sabbath Day but the other six Days and Nights none without special Favour.

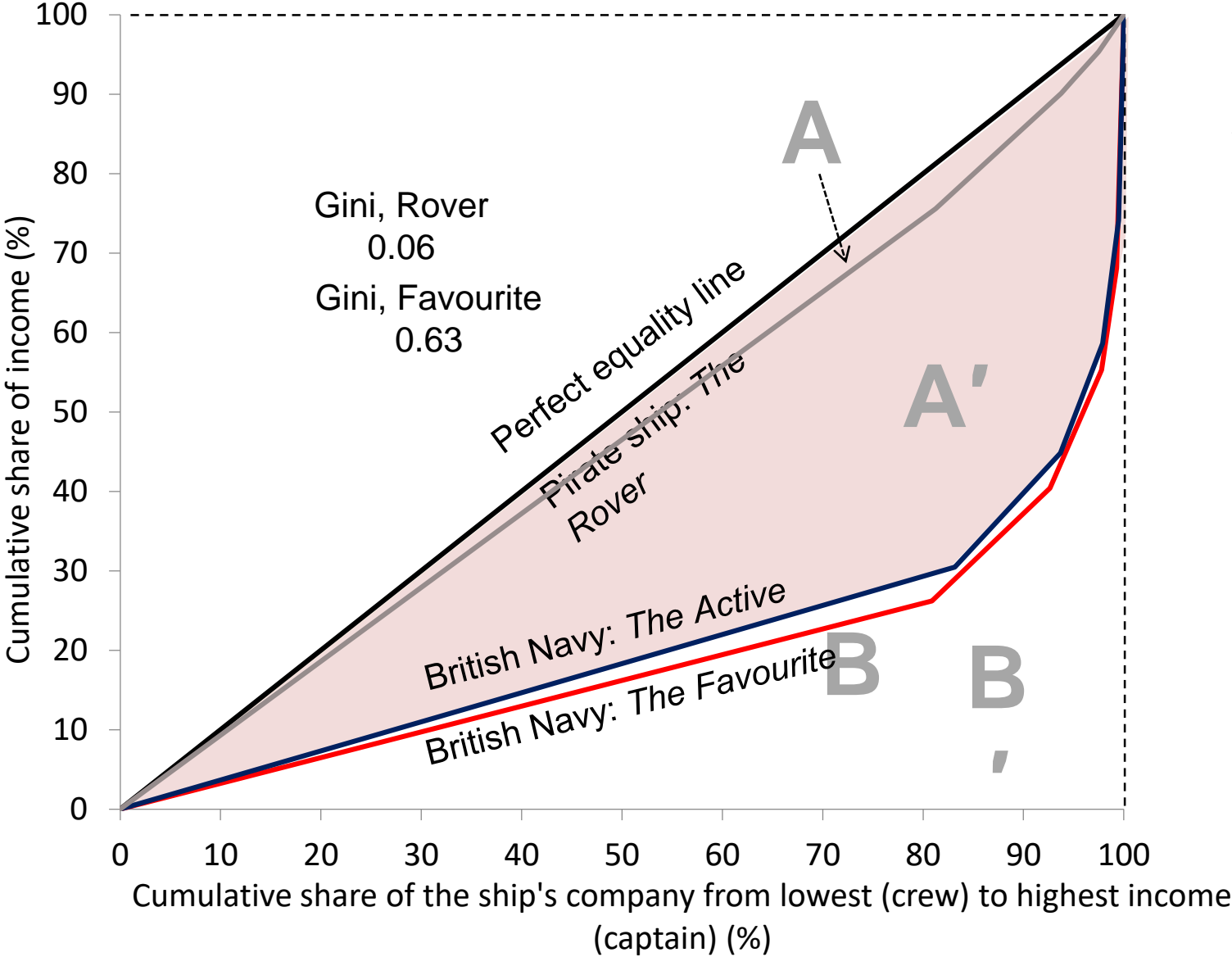
Connecting institutions to measurement of inequality



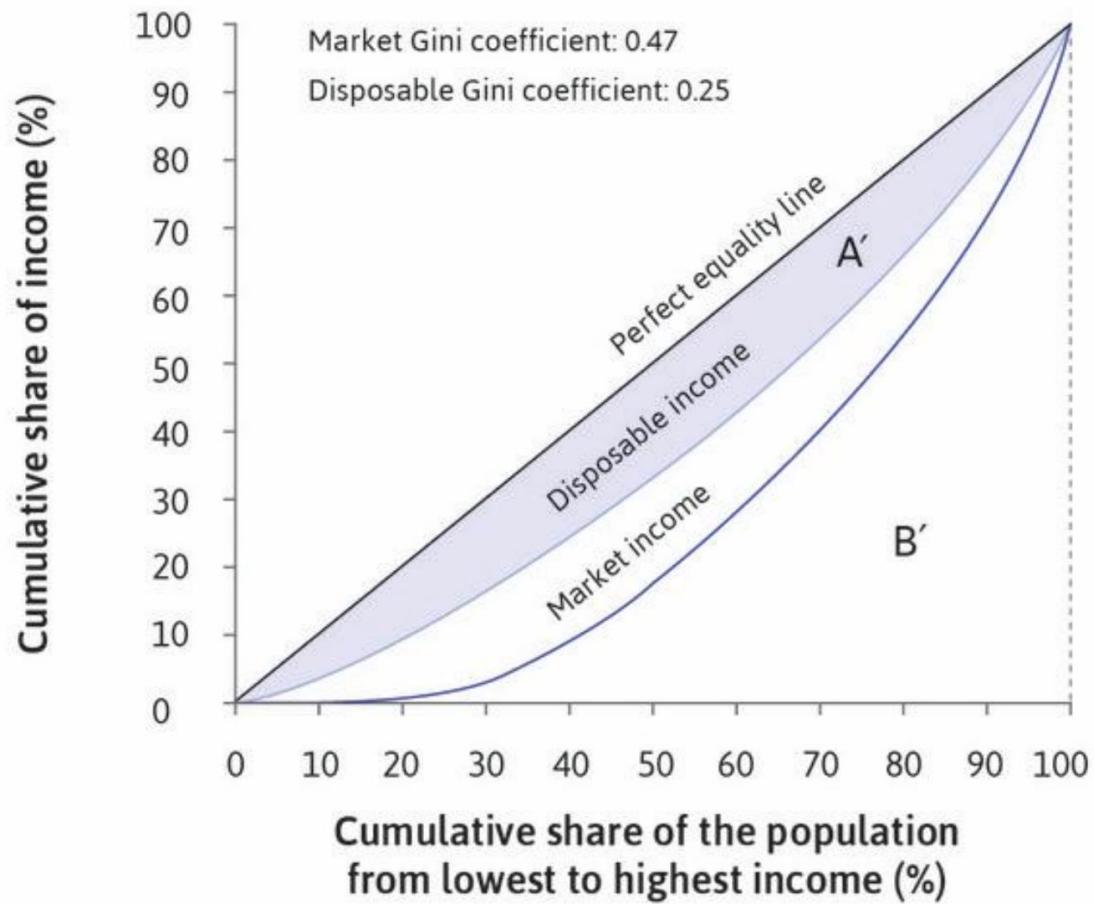
Constitutions and contracts
Inequality in the division of the spoils:
pirates and the Royal Navy

Constitutions and contracts

Inequality in the division of the spoils: pirates and the Royal Navy



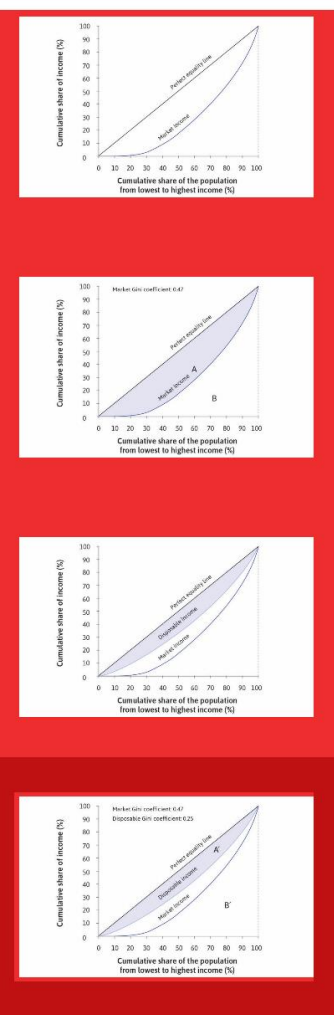
A Pirate Ship Lorenz Curve and Gini Coefficient



The Gini for disposable income

The Gini coefficient for disposable income is lower: the ratio of areas A' (between the disposable income curve and the perfect equality line) and A' + B' (below the perfect equality line) is 0.25.

Figure 5.15 Distribution of market and disposable income in the Netherlands (2010).



Countries ranked from lowest market income inequality to highest market income inequality

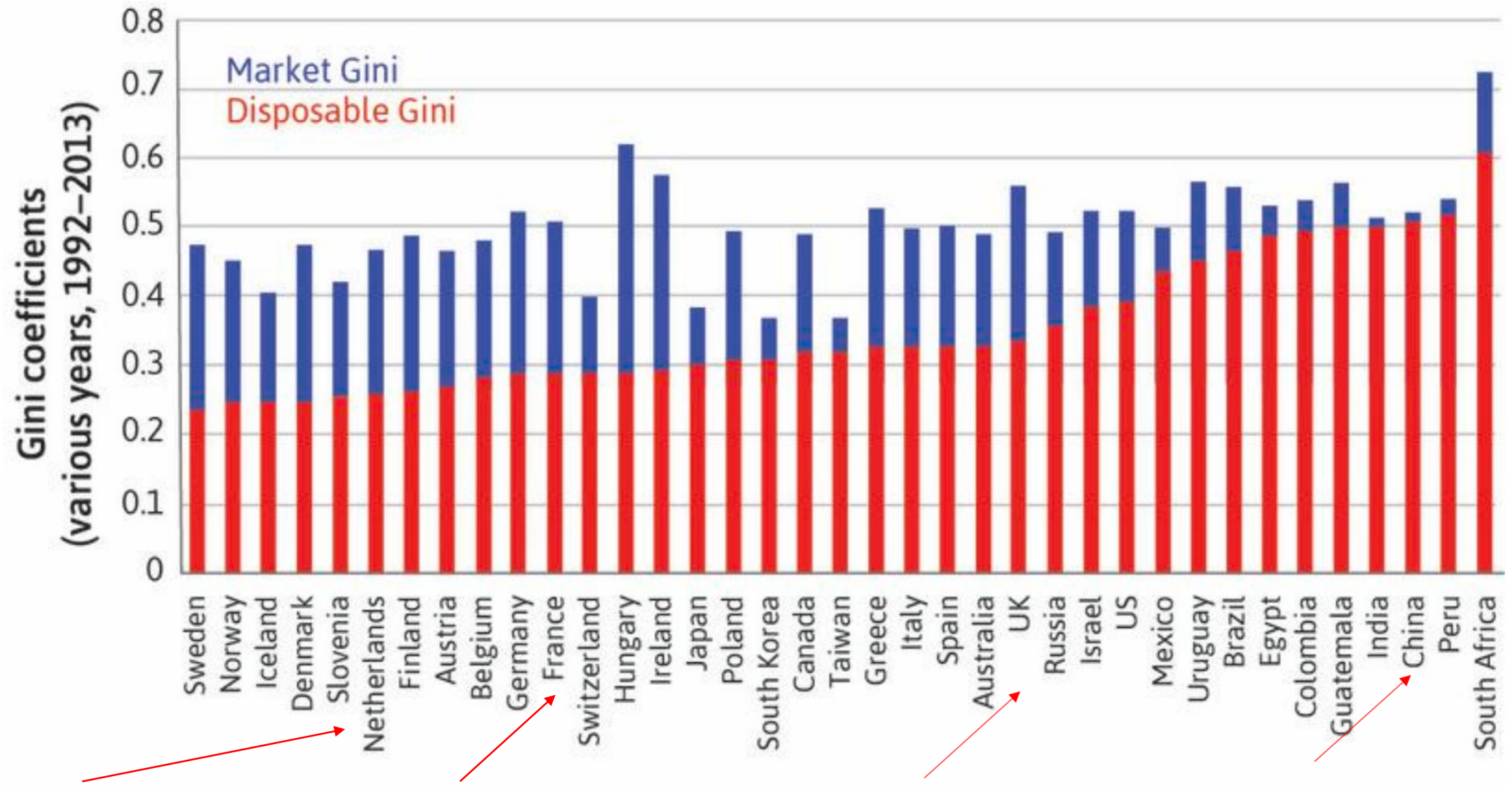


Figure 5.16 Income inequality in market and disposable income across the world.

A simple parable illustrates basic concepts for the study of inequality

- Introducing: a bargaining model, starring Angela and Bruno...
- People occupy different positions given by economic institutions: structural heterogeneity
- Interactions may be coerced or voluntary
- Where voluntary, there must be (at least weakly) **mutual gains possible**
- There is therefore a **conflict over the distribution of the mutual gains**
- **Theory and data**: Operation Barga (land tenure conflicts and reforms) in India

How do institutions matter?

Scenario	The Model: Angela and Bruno's interaction	Real-world examples
A	Independence: Angela works the land on her own, and everything she produces is hers.	Independent farmers with access to land (either free, or because they own it) have been common in history ever since farming began.

How do institutions matter?

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A	Independence: Angela works the land on her own, and everything she produces is hers.	Independent farmers with access to land (either free, or because they own it) have been common in history ever since farming began.
B	Rule of force: Slavery. There is a second person, who does not farm, but is able to take some of the harvest. He is called Bruno. Bruno is heavily armed, and Angela is, effectively, his slave.	Also common throughout history: slavery and other forms of coerced labour in mines and plantations was the basis of much of the economy of North and South America after the arrival of Europeans. It persists today – among domestic workers and prostitutes – though in most countries illegally. The UK's Modern Slavery Act was passed in 2015.

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C	Property rights and the rule of law: Laws protect Angela from coercion but give Bruno ownership of the land. If she wants to farm his land, she must agree, for example, to pay him some part of the harvest. But she has the right to say no. He has to make her an offer that she will accept.	In manufacturing, farming, and other kinds of work, owners of land and other capital goods employ workers, or make their land available to the landless for rent, a common arrangement today and for thousands of years. The sharecropping in Bengal in India is an example.

How do institutions matter?

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D	Property rights, the rule of law, and the right to vote: the rules of the game are a bit more in Angela's favour. She and her fellow farmers achieve the right to vote and legislation is passed that increases Angela's claim on the harvest.	Capitalism and democracy in the 20 th century and today.

Figure 5.5. **Coercion**: The maximum technically feasible transfer from Angela to Bruno.

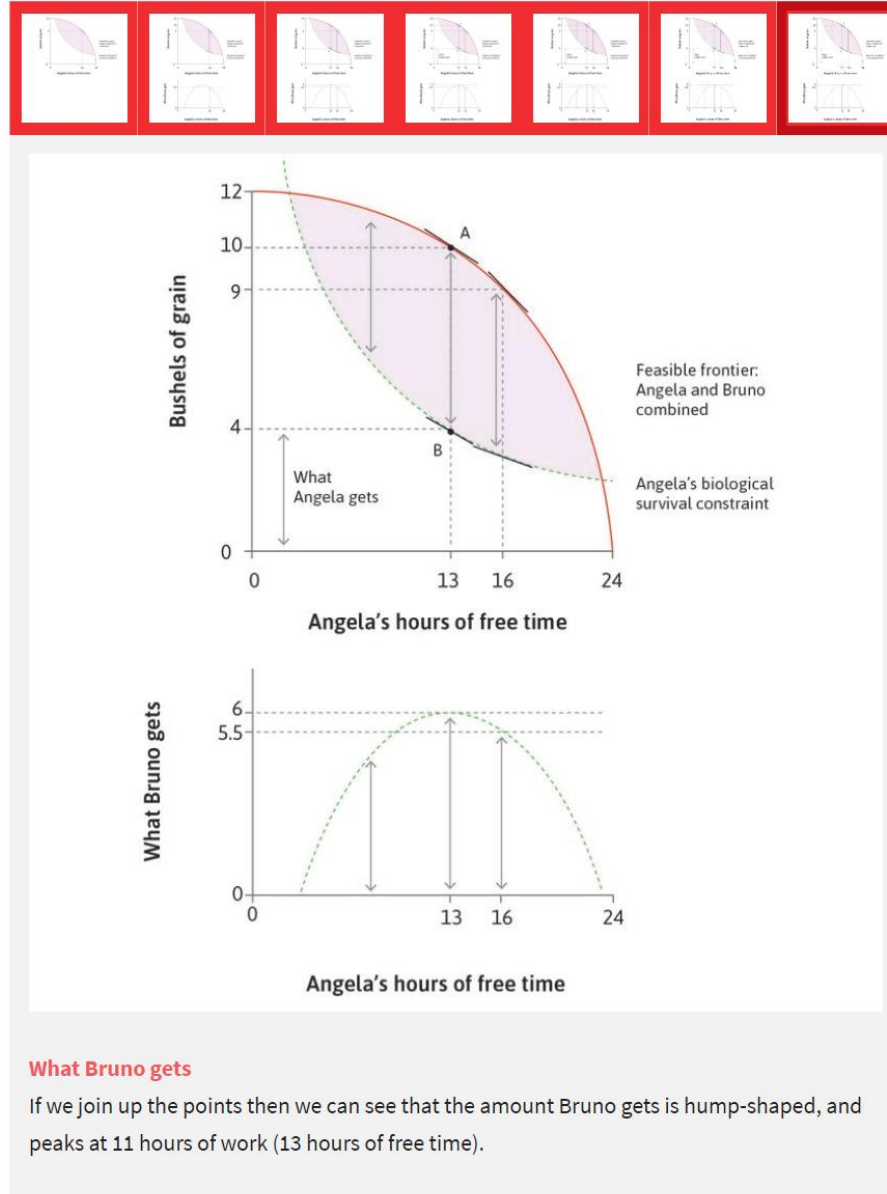
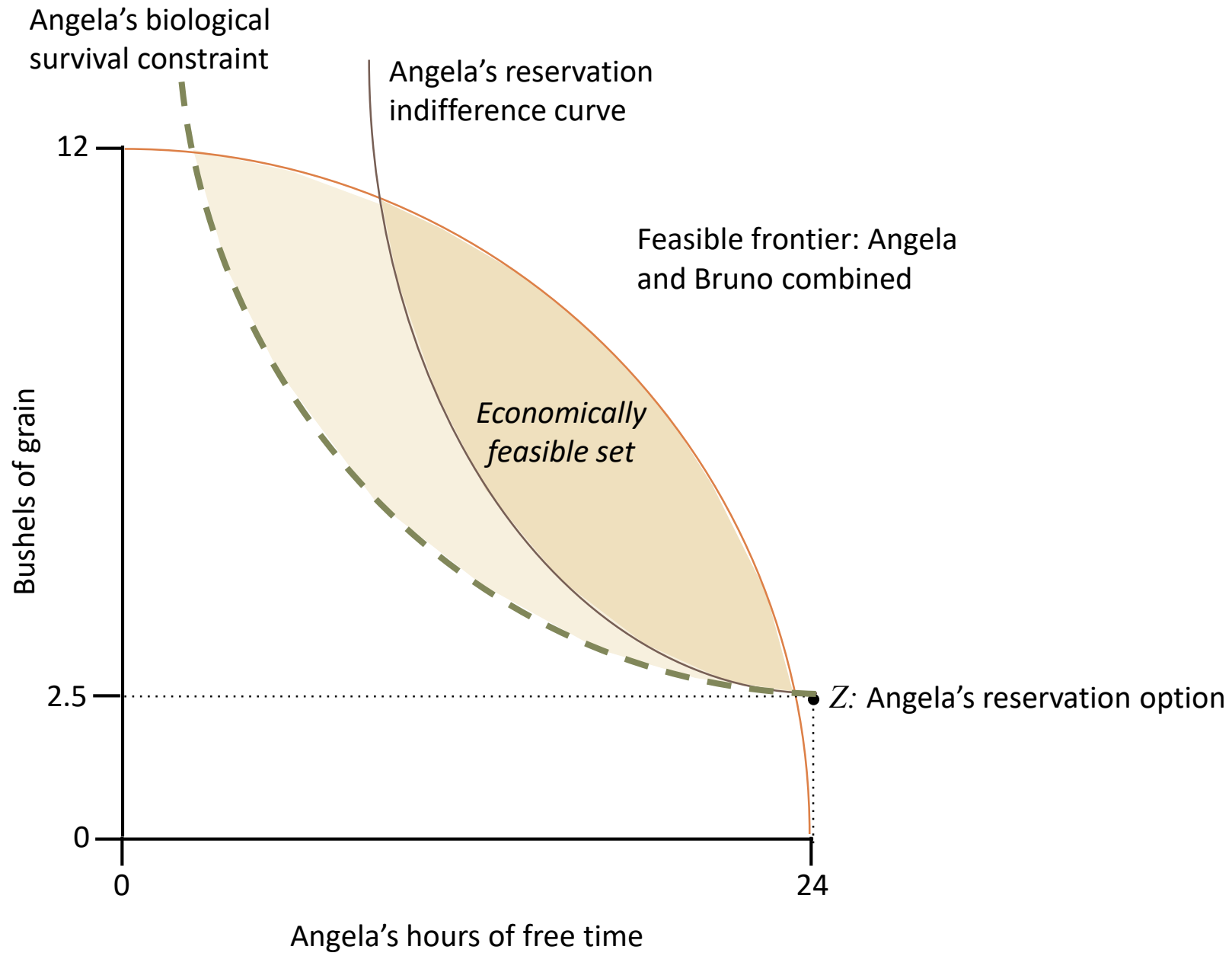
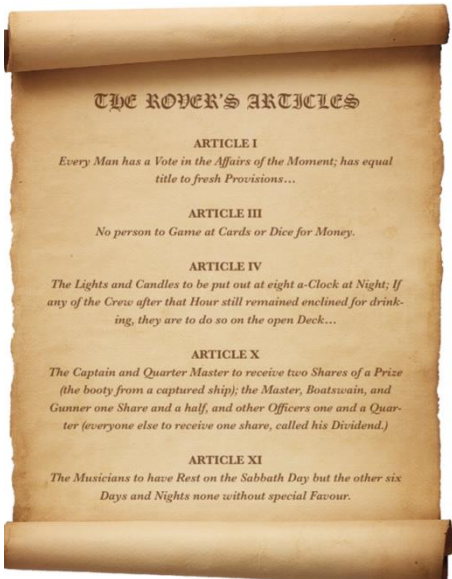


Figure 5.5 Coercion: The maximum technically feasible transfer from Angela to Bruno.

Figure 5.6. Economically feasible allocations **when exchange is voluntary.**



Evaluation: every economic transaction involves both mutual gains & conflicts of interest



Description
(Facts)

Allocation: who does what and who gets what

Evaluation
(Values)

Is the allocation efficient?
Would there be mutual gains from moving to some other allocation?

Is the allocation fair? Is there some other allocation that would be fairer? Are the rules of the game that produced the allocation fair?



Is the allocation efficient?
Would there be mutual gains from moving to some other allocation?

EXERCISE 12.9 CAPITALISM AMONG CONSENTING ADULTS

Should all voluntary contractual exchanges be allowed among consenting adults?

State what you think about the following (hypothetical) exchanges. You may assume in each case that the people involved are sane, rational adults who have thought about the alternatives and consequences of what they are doing. In each case, decide whether you approve, and if you do not approve, whether you think the transaction should be prohibited. In each case explain why the transaction described produces mutual benefits (that is, it is a Pareto improvement over not allowing the exchange).

1. A complicated medical procedure has been discovered that cures a rare form of cancer in patients who would otherwise certainly die. Staff shortages make it impossible to treat all those who would benefit, and the hospital has established a policy of first come, first served. Ben, a wealthy patient who is at the bottom of the list, offers to pay Aisha, a poor person on the top of the list, \$1 million to exchange places. If Aisha dies (which is very likely), then her children will inherit the money. Aisha agrees.
2. Melissa is 18. She has been admitted to a good university but does not have any financial aid, and cannot get any. She signs a four-year contract to be a stripper on the Internet and will begin work when she is 19. The company will pay her tuition fees.
3. You are waiting in line to buy tickets for a movie that is almost sold out. Someone from the back of the line approaches the woman in front of you and offers her \$25 to exchange positions in the line (he takes her position in front of you and she takes his at the back of the line).
4. A politically apathetic person, who never votes, agrees to vote in an election for the candidate who pays him the highest amount.
5. William and Elizabeth are a wealthy couple who give birth to a baby with a minor birth defect. They sell this baby to their (equally wealthy) neighbours and buy a child without any birth defects from a family who needs the money.
6. An individual with an adequate income, decides that he would like to sell himself to become the slave of another person. He finds a buyer willing to pay his asking price. The aspiring slave will use the money to further his children's education.



Is the allocation fair? Is there some other allocation that would be fairer? Are the rules of the game that produced the allocation fair?

What should we study when we study economics?

[Economics is the study of] human behaviour as a relationship between given ends and scarce means.

An Essay on the Nature and Significance of Economics, **1932** Lionel Robbins

Economics as usually taught to undergraduates is *not* about institutions (rules of the game) and power ...

In a perfectly competitive market, it really doesn't matter who hires whom, so have labour hire capital.

1957 Paul Samuelson

An economic transaction is a solved political problem ... Economics has gained the title 'Queen of the Social Sciences' by choosing solved political problems as its domain.

'The economics and politics of consumer sovereignty', **1972** Abba Lerner in the *American Economic Review*

The firm ... has no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting between any two people ... **Wherein then is the relationship between a grocer and his employee any different from that between a grocer and his customer?**

1972 Alchian and Demsetz, *American Economic Review*

But about 30 years ago, things began to change in economics

[T]he reason is that a **grocer can deprive the employee of the assets he works with and hire another employee to work with these assets** while the customer can only deprive the grocer of his custom ... and it is presumably **not very difficult for the grocer to find another customer..**

'An economist's perspective on the theory of the firm' **1989** Oliver Hart

And in 1989, a surprise change in the rules of the game

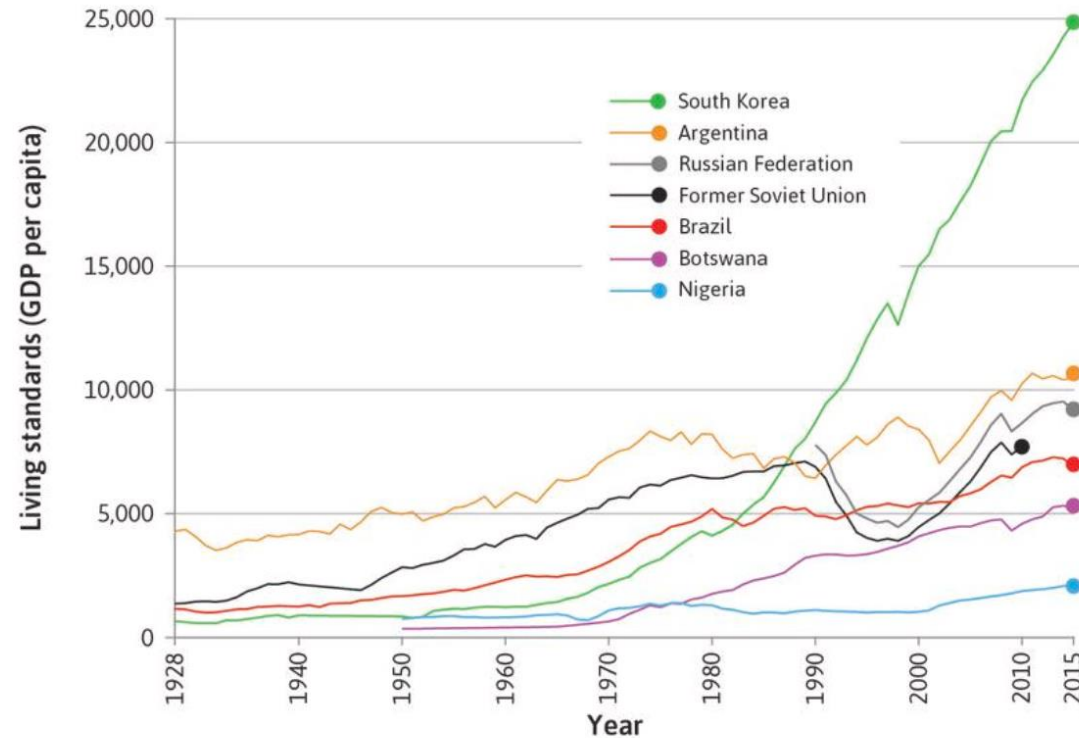


Figure 1.11 Divergence of GDP per capita among latecomers to the capitalist revolution (1928–2015).

30 years later, we can teach economics by extending its domain to unsolved political problems using principal-agent models
The economics of transition provides a rich motivation and research findings

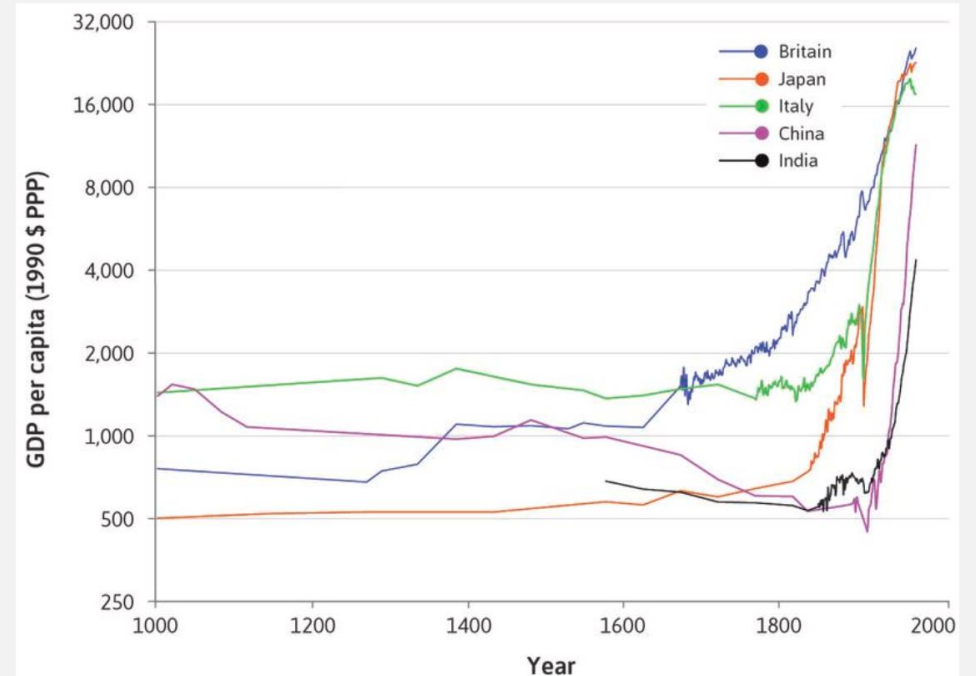
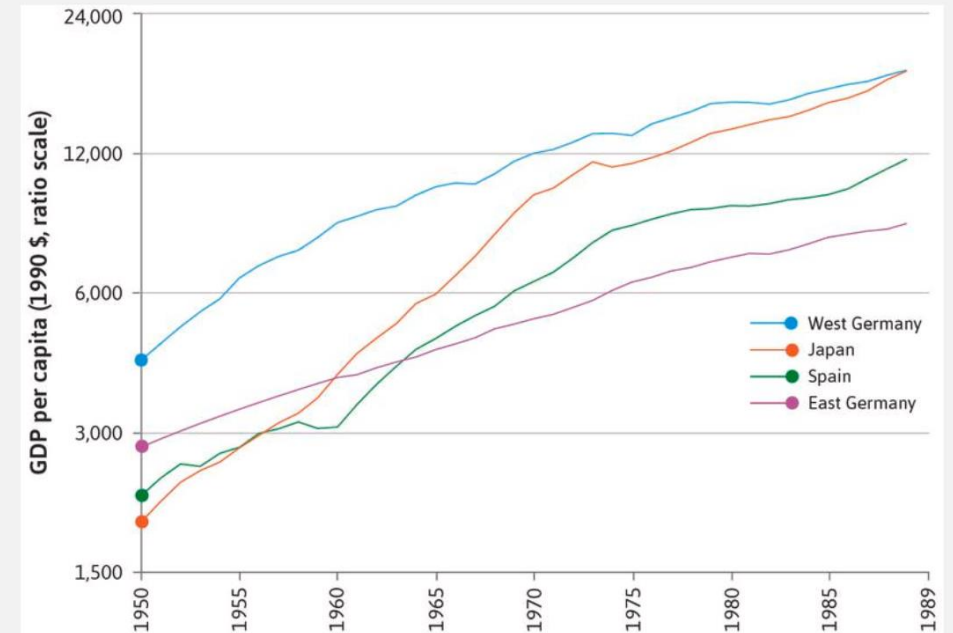
HOW ECONOMISTS LEARN FROM FACTS

Do institutions matter for growth in income?

We can observe that capitalism emerged at the same time as, or just before, both the Industrial Revolution and the upward turn in our hockey sticks. This would be consistent with the hypothesis that capitalist institutions were among the causes of the era of continuous productivity growth. But the emergence of a free-thinking cultural environment known as ‘[The Enlightenment](#)’ also predated or coincided with the upturn in the hockey sticks. So was it institutions, or culture, both, or some other set of causes? Economists and historians disagree, as you will see in Unit 2, when we ask ‘What were the causes of the Industrial Revolution?’

A method for doing this is called a **natural experiment**. It is a situation in which there are differences in something of interest—a change in institutions for example—that are not associated with differences in other possible causes.

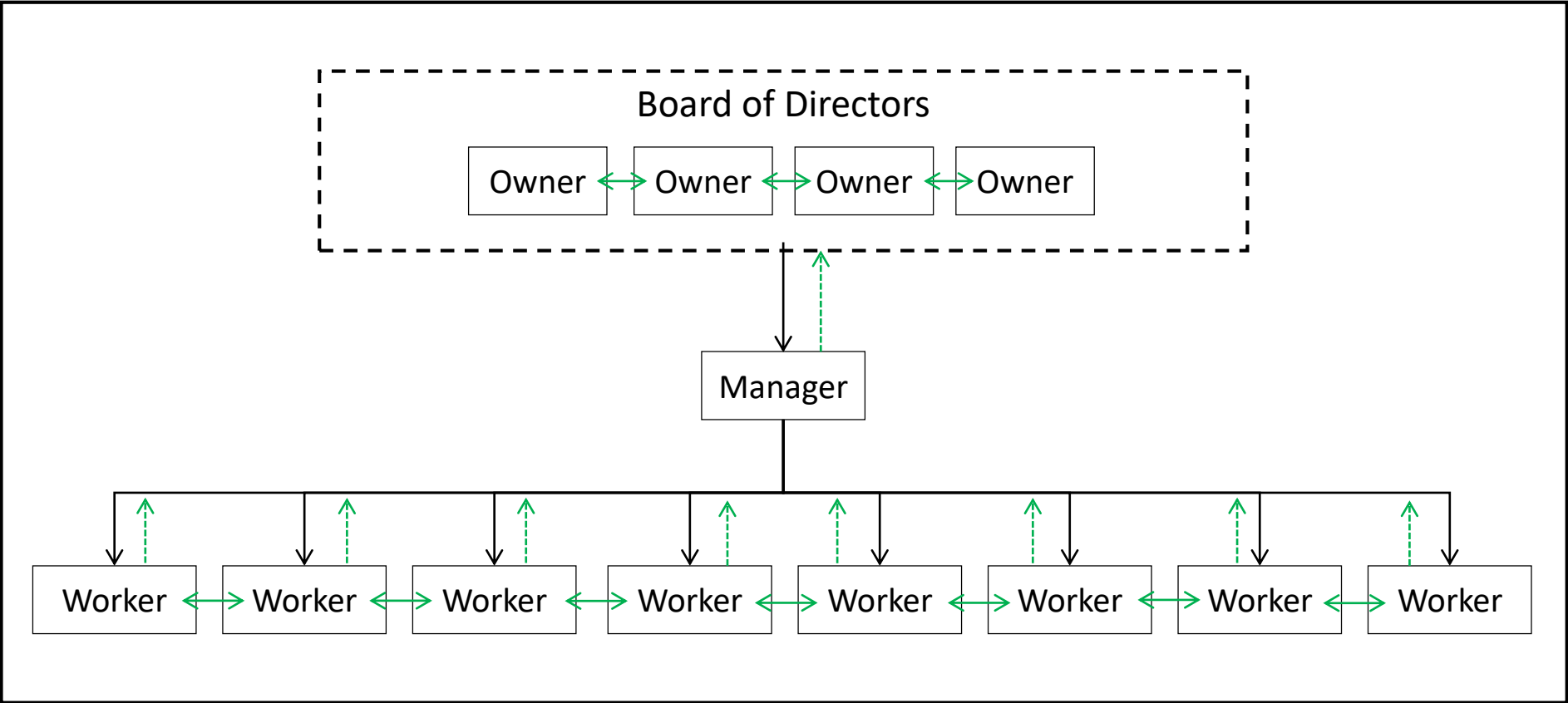
The division of Germany at the end of the Second World War into two separate economic systems—centrally planned in the east, capitalist in the west—provided a natural experiment. During this time a political ‘Iron Curtain’, as the British Prime Minister Winston Churchill described it, divided the country. It separated two populations that until then had shared the same language, culture, and capitalist economy. 9



We then apply the 'rules of the game' framework to the modern firm

- The firm as a social organization
- People in different positions have differing (both common and conflicting) interests: **structural heterogeneity**
- Employment makes possible **mutual gains** and entails a **conflict over their distribution**
- The **labour contract is incomplete**: effort on the job cannot be enforced by a court
- How differences in unemployment affect the worker's fallback position and hence the wage and the effort level
- **Theory and data**: Why workers speed up when the economy slows down (evidence)

Figure 6.1. The firm's actors and its decision-making and information structures.



The conflicts of interest in the firm

WHEN ECONOMISTS AGREE

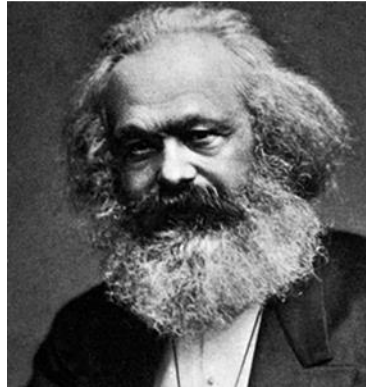
Coase and Marx on the firm and its employees

The writer George Bernard Shaw (1856–1950) joked that ‘if all economists were laid end to end, they would not reach a conclusion.’

This is funny, but not entirely true.

Even more striking is that two economists from different centuries and political orientations came up with similar ways of understanding the firm and its employees.

Recall that Coase had also defined the firm by its political structure: ‘If a workman moves from department Y to department X, he does not go because of a change in prices but because he is ordered to do so.’ He sought to understand why firms exist at all, quoting his contemporary D. H. Robertson’s description of them as ‘islands of conscious power in this ocean of unconscious cooperation.’

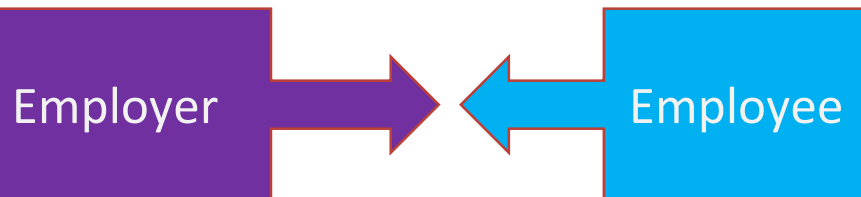


Actors & their interactions – a foundation for understanding the aggregate economy

A principal agent problem ...

- entails conflicts of interest
- arises when information is asymmetric because actions are hidden from principal / not verifiable in court
 - incomplete contracts
 - market failures are ubiquitous
 - institutions and social norms matter

In the labour market, ...



What is the conflict of interest over?

What is left out of the contract?



Work effort is not contractually enforceable: An employee's best response to the wage.

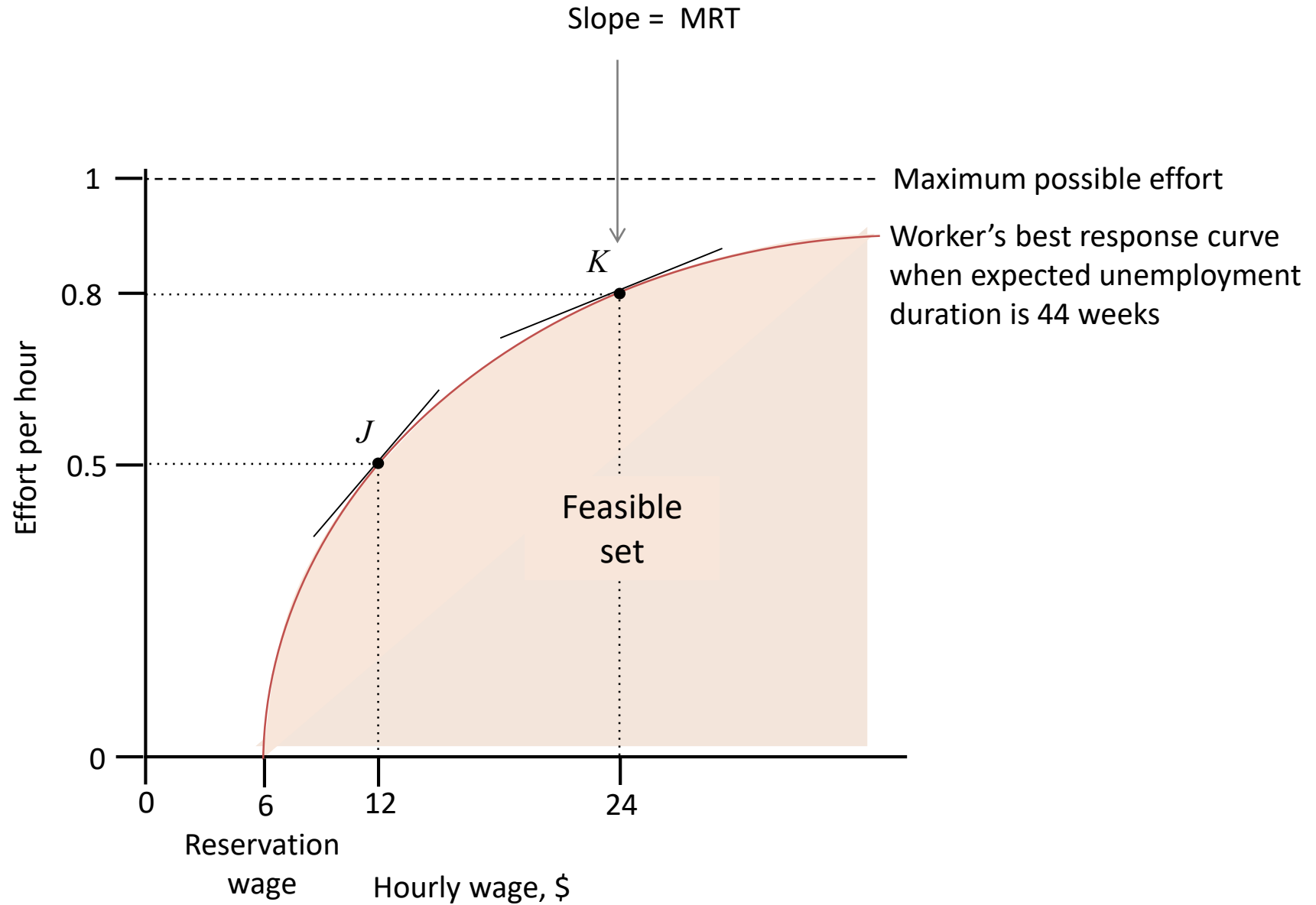


Figure 6.5. The employer's indifference curves: isocost lines for effort.

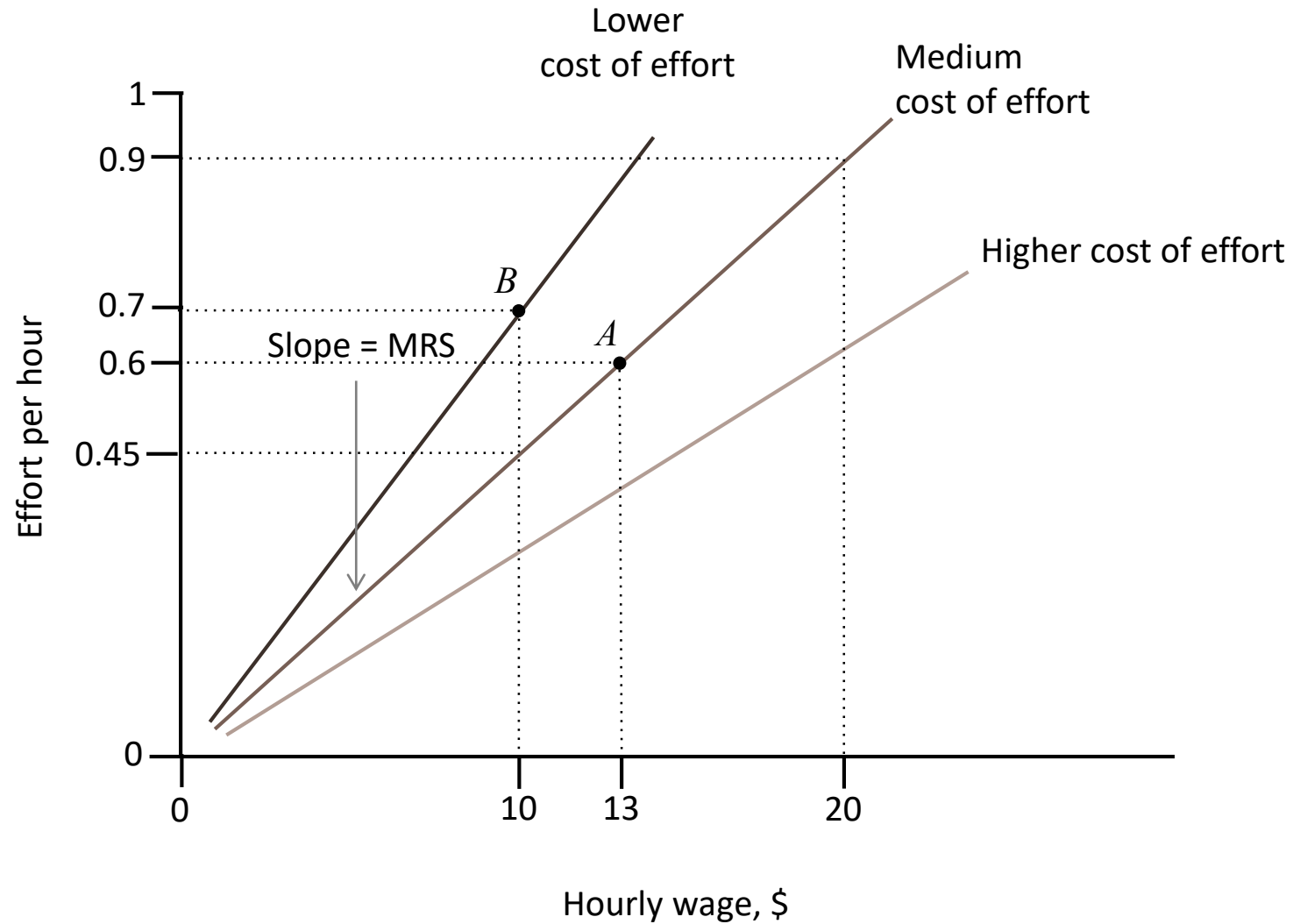


Figure 6.6. The employer **sets the wage** to minimise the cost of effort.

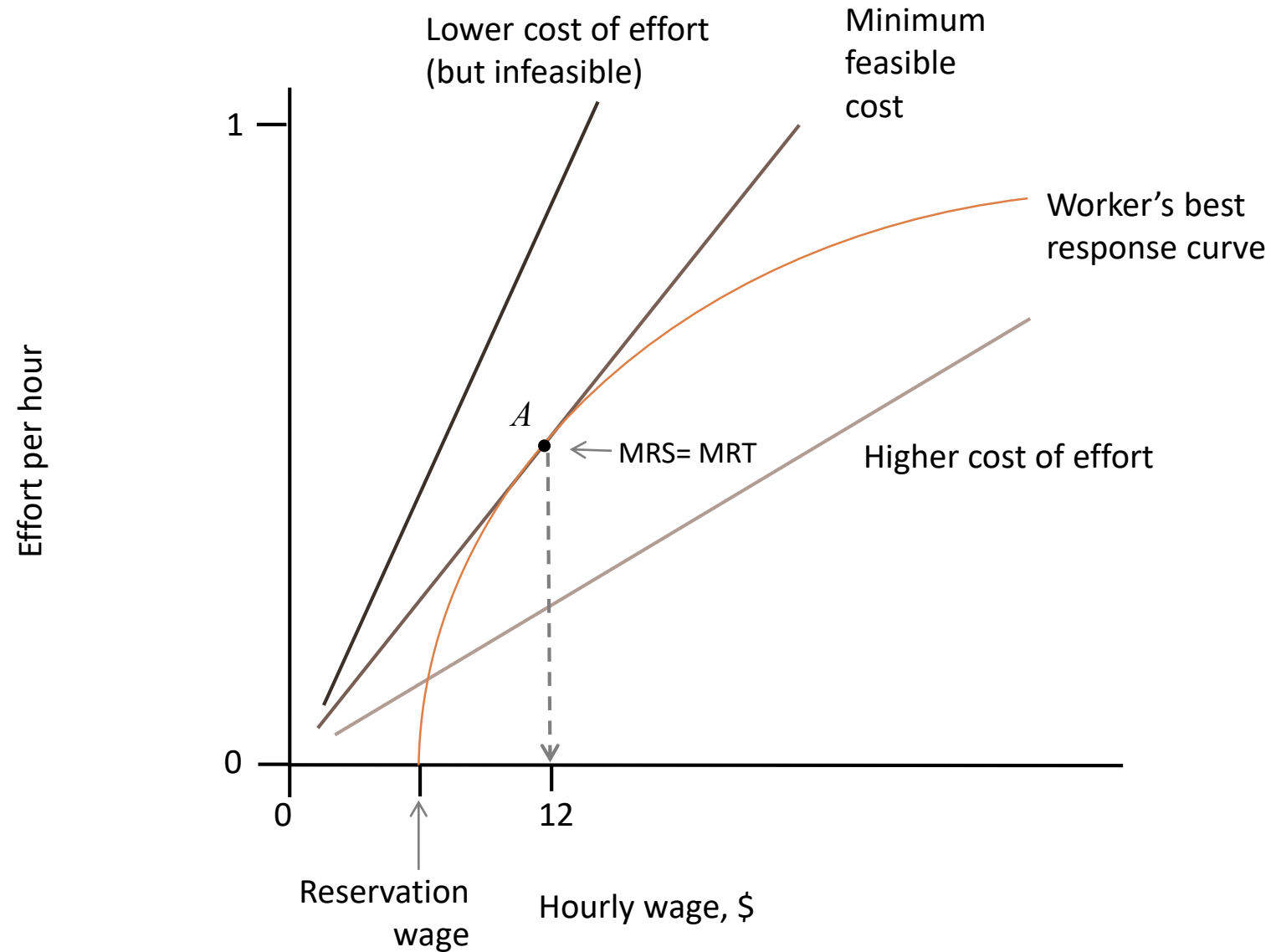
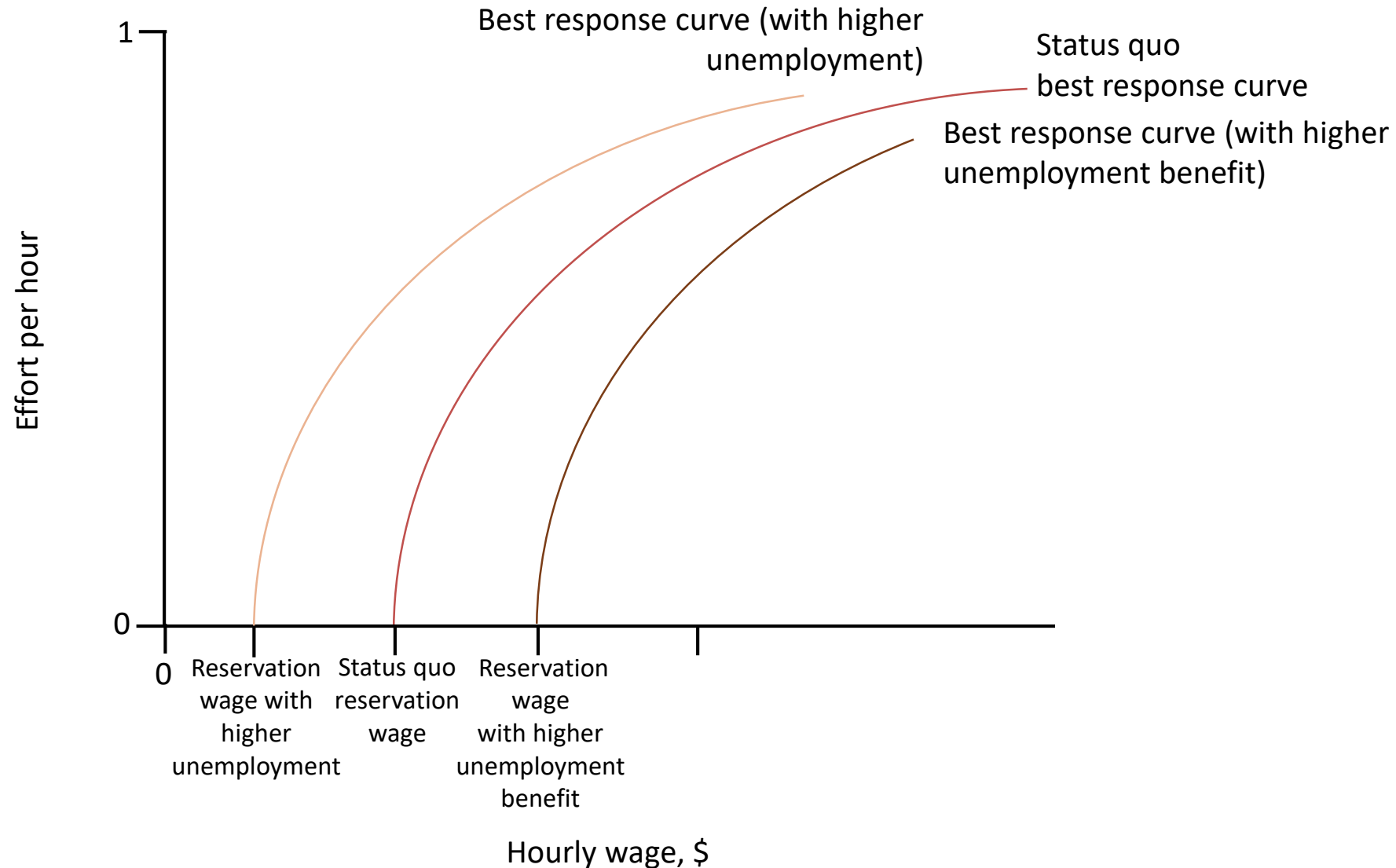


Figure 6.7. The best response curve depends on the level of unemployment and the unemployment benefit.



Theory and data: Edward Lazear et. al. on why workers speed up when the economy slows down

HOW ECONOMISTS LEARN FROM FACTS

Workers speed up when the economy slows down

The idea that employment rents are an incentive for effort is illustrated in a study by Edward Lazear (an economic adviser to President George W. Bush) and his co-authors. They investigated, during the global financial crisis, to see how the management of a firm specialized in the turbulent economic conditions. The firm specializes in services such as insurance-claims processing, computer-based test centres, and operates in 12 US states. The nature of the management of the firm to track the productivity of worker effort.

It also allowed Lazear and his colleagues to use the firm to analyse the effect on worker productivity of the worst recession since the Depression.

When unemployment rose, workers could expect a longer spell of unemployment if they lost their job. Firms did not use their increased bargaining power to lower wages as they could have, fearing the reaction of their employees.

EXERCISE 6.6 LAZEAR'S RESULTS

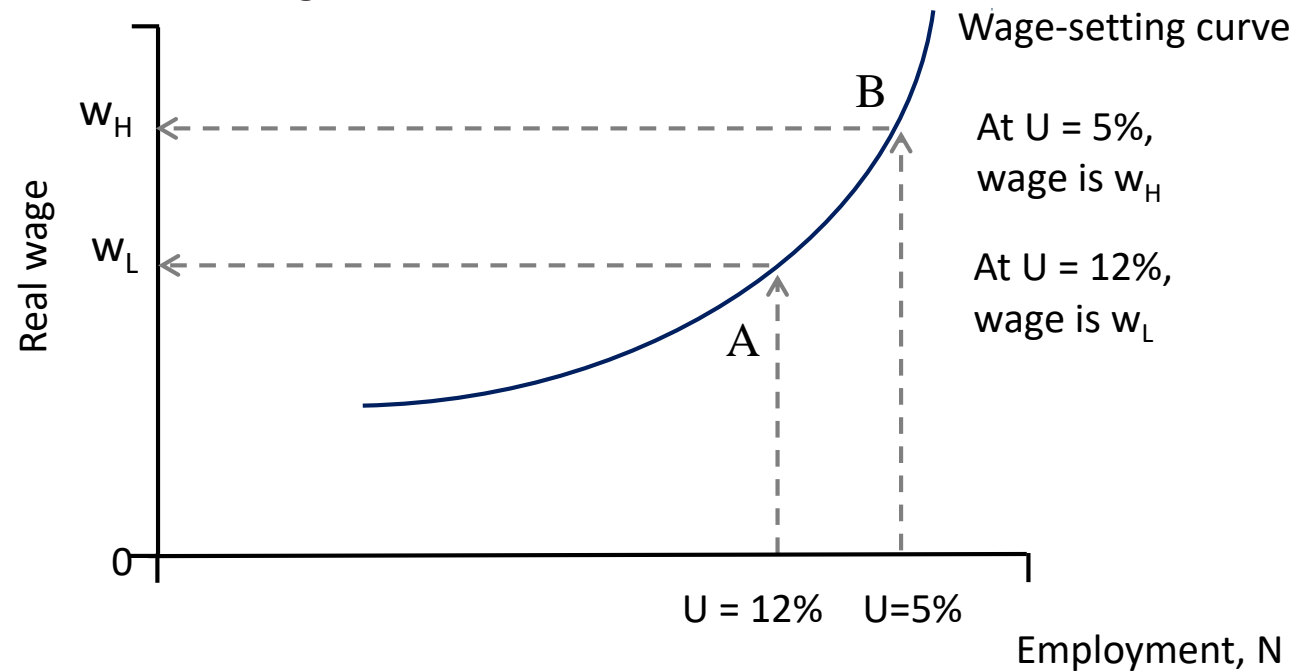
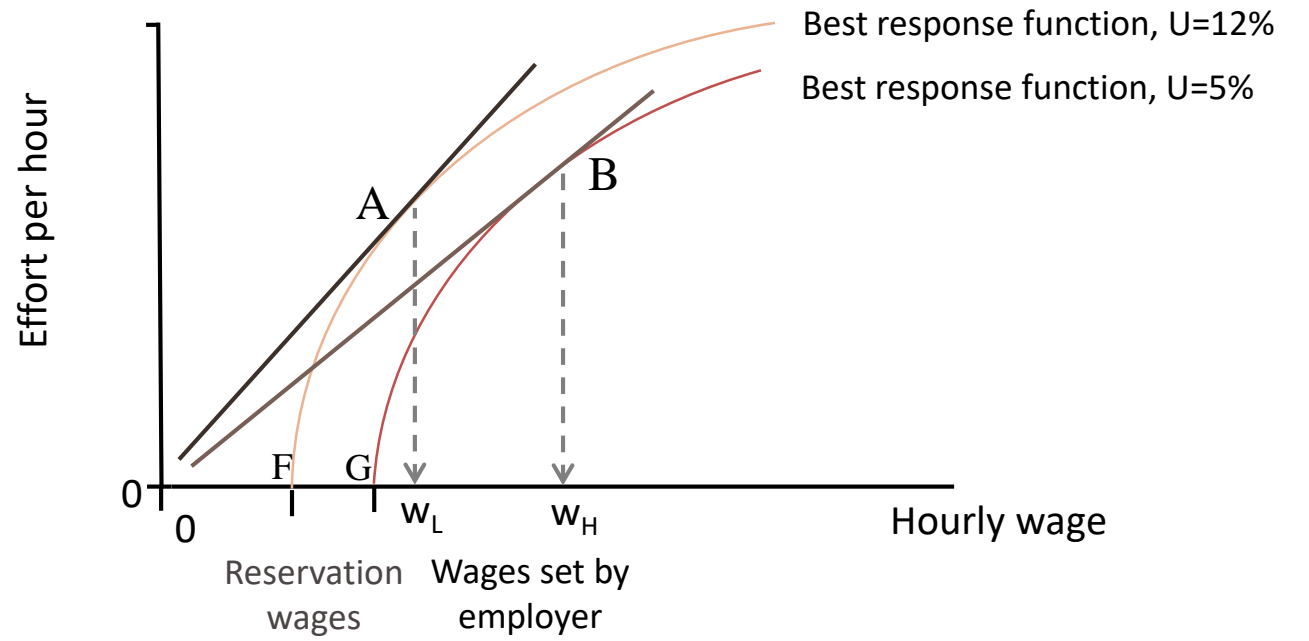
Use the best response diagram to sketch the results found by Lazear and co-authors in their study of a firm during the global financial crisis.

1. Draw a best response curve for each of the following years and explain what it illustrates:
 - a. the pre-crisis period (2006)
 - b. the crisis years (2007–8)
 - c. the post-crisis year (2009)Assume that the employer did not adjust wages.
2. Is there a reason why a firm might not cut wages during a recession? Think about the research of Truman Bewley and the experimental evidence about reciprocity in Unit 4.

From conflicts within the firm to economy-wide unemployment and inequality

- The model of the firm gives us an **economy-wide wage curve**
- This is the basis of later macroeconomic model: **goodbye to the micro-macro schizophrenia**
- **Theory and data**: the US wage curve
- The labour market, the Lorenz curve and income inequality.
- Evaluation: **efficiency and fairness**.

Figure 9.5. Deriving the wage-setting curve:
Varying the unemployment rate in the economy.



Micro ↔ Macro → Data

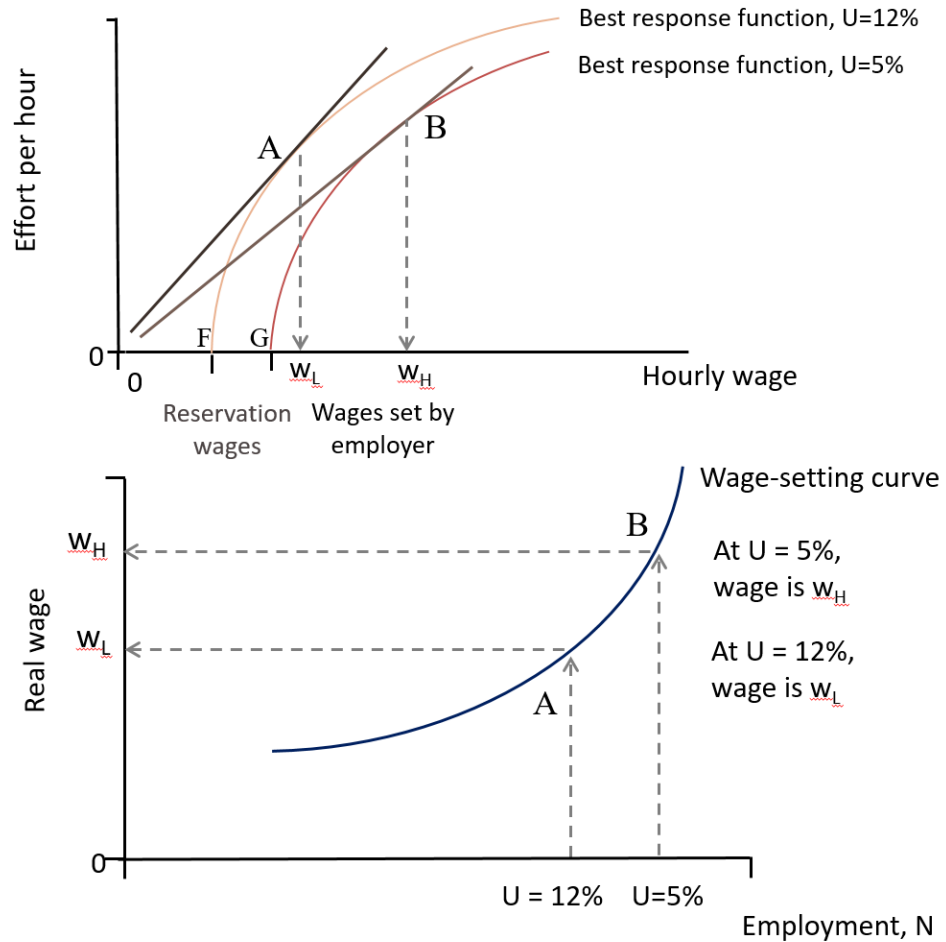
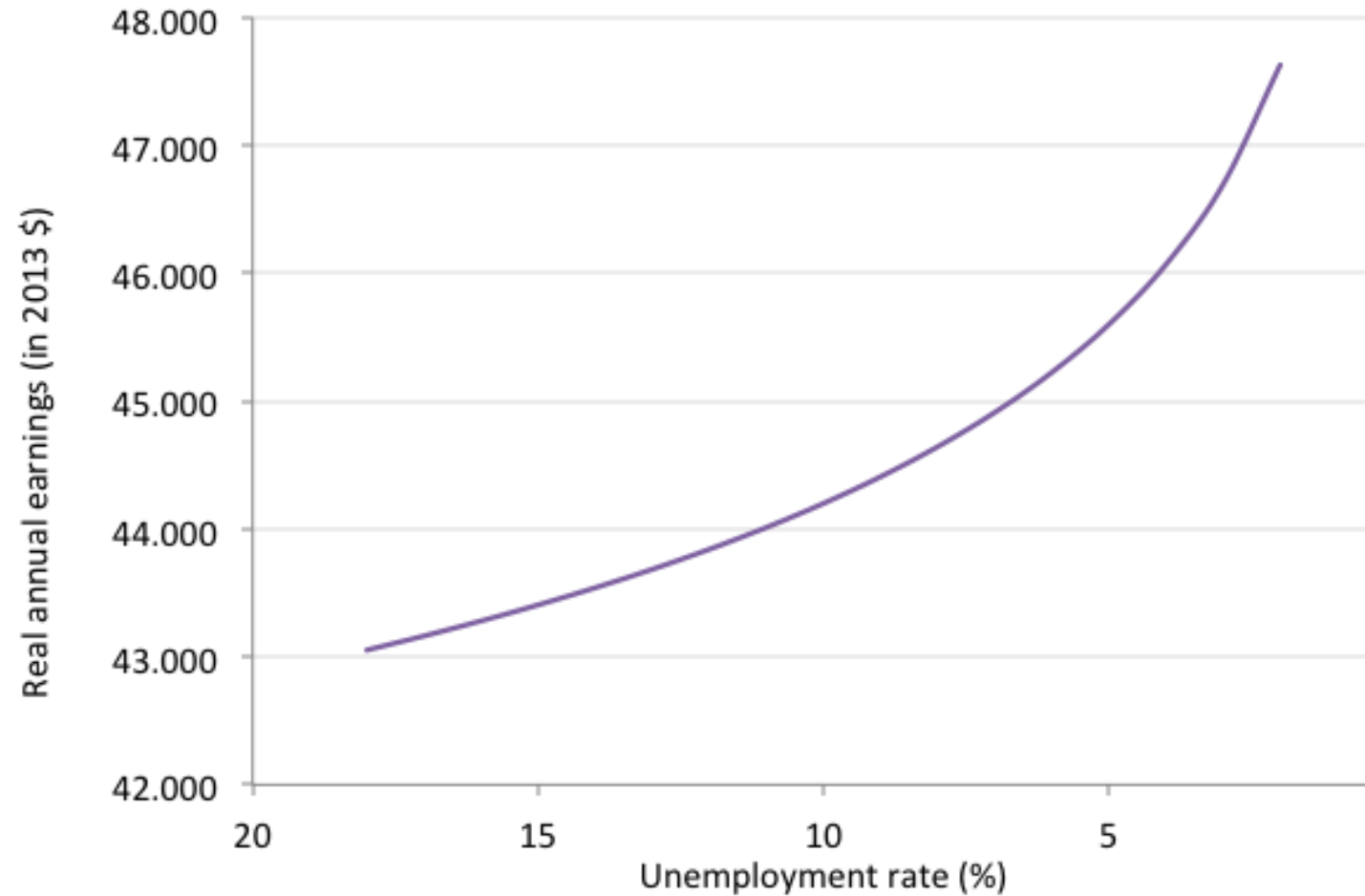
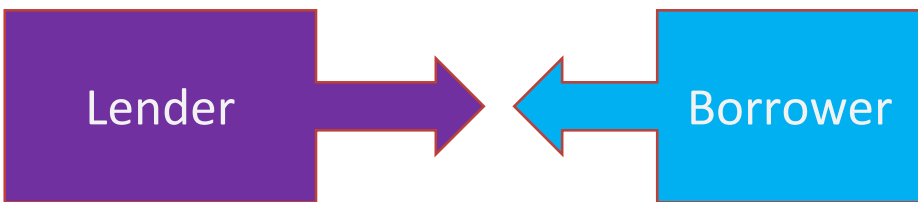
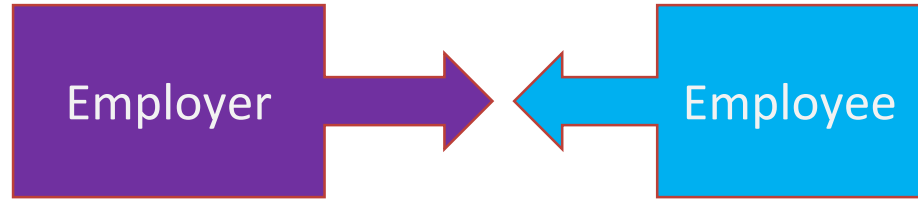


Figure 9.6. A wage-setting curve estimated for the United States economy (1979-2013).



Aggregate demand and fluctuations – a second principal-agent problem

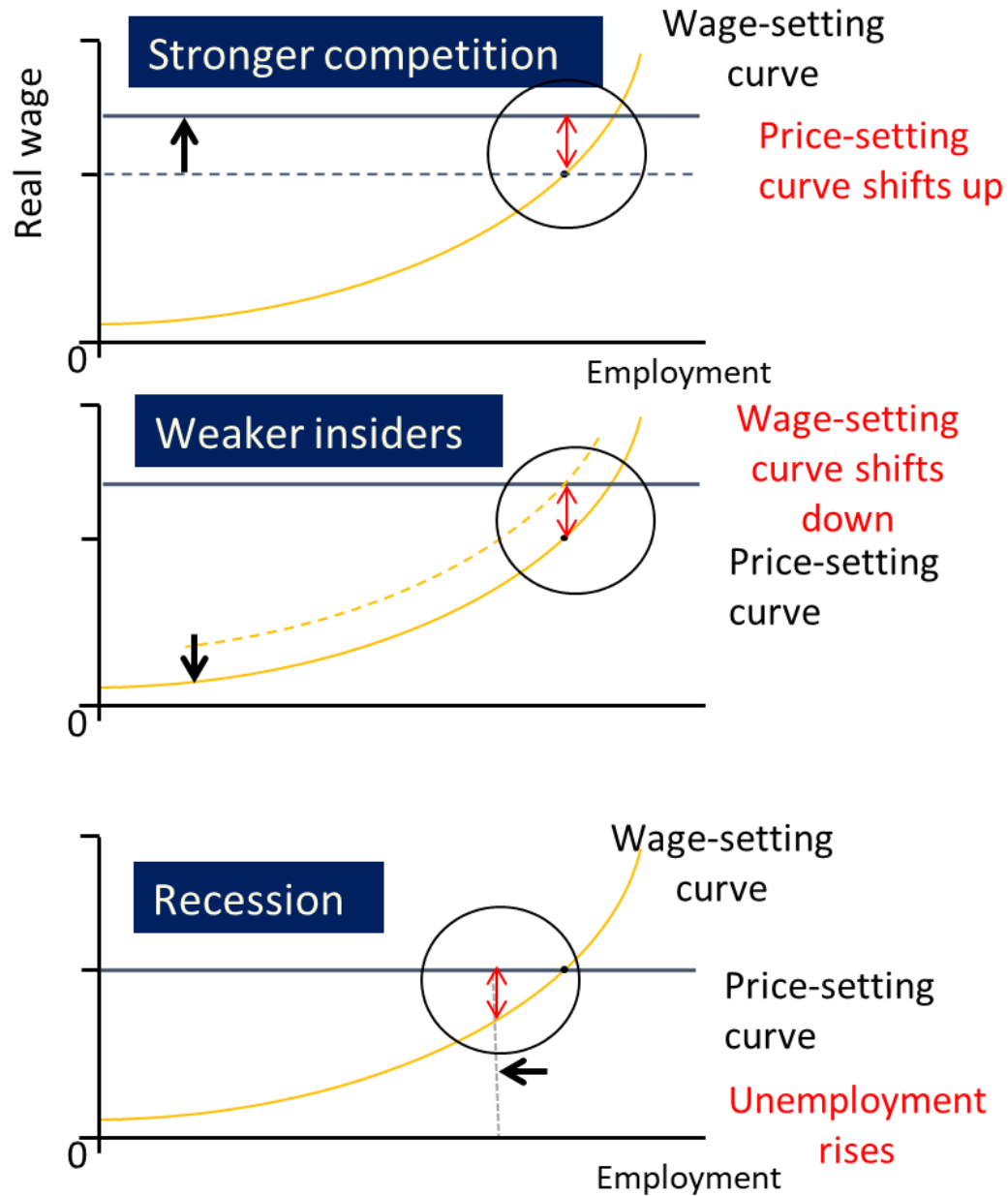


	Actors	Conflict of interest over	Enforceable contract covers	Left out of contract (or unenforceable)	Result
Labour market (Units 6 and 9)	Employer Employee	Wages, work (quality and amount)	Wages, time, conditions	Work (quality and amount), duration of employment	Effort under-provided; unemployment
Credit market (Units 10 and 12)	Lender Borrower	Interest rate, conduct of project (effort, prudence)	Interest rate	Effort, prudence, repayment	Too much risk, credit constraints

Figure 10.19 Principal-agent problems: The credit market and the labour market.

→ Heterogeneous agents, credit-constrained households, and multiplier effects in the aggregate economy

Why is inflation falling?



1. Owners' power falls relative to consumers

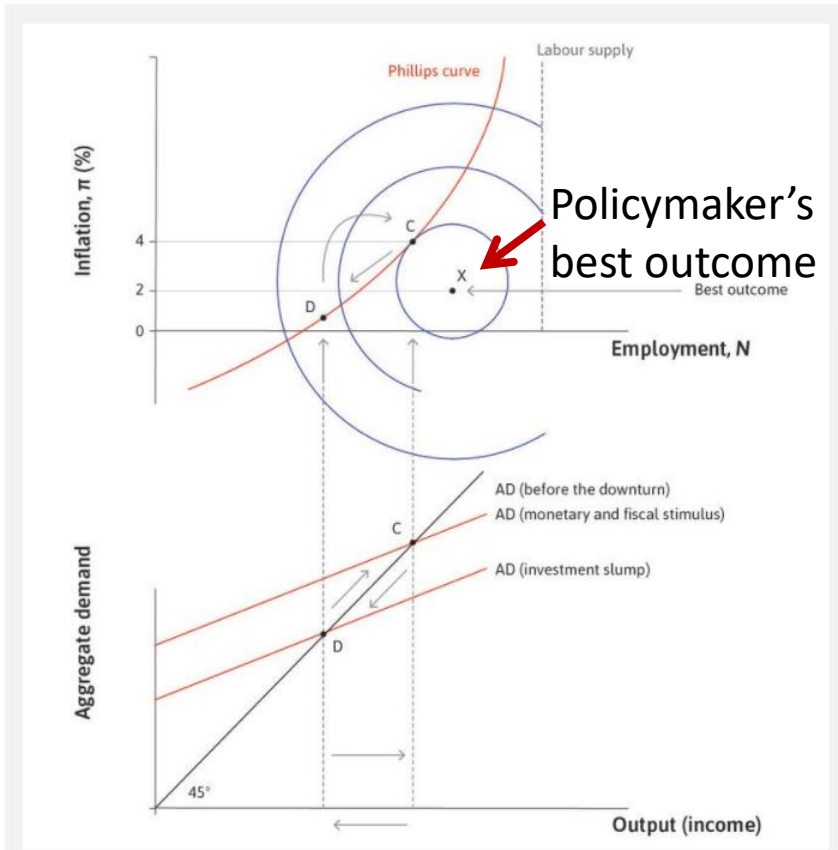
Always ask: what has happened to the bargaining gap?

2. Employees' power falls relative to owners

3. Employees' power falls relative to owners in a recession

Government and central bank as actors – using constrained optimization

Read more here on the CORE blog



The effect of intervention
 The increase in output from higher aggregate spending reduces unemployment and raises inflation. The economy moves back along the Phillips curve to point C.

Figure 15.18 A policy intervention to restore employment and output after a fall in investment.

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Economics for a changing world

Resources | Glossary | Fact checker | ...

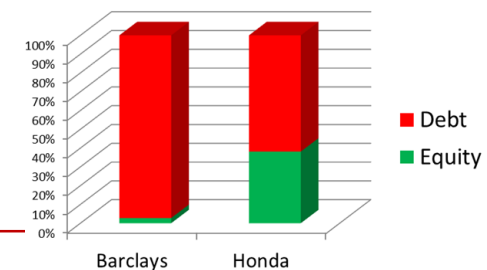
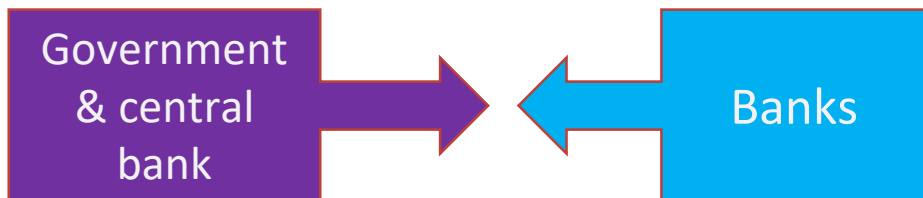
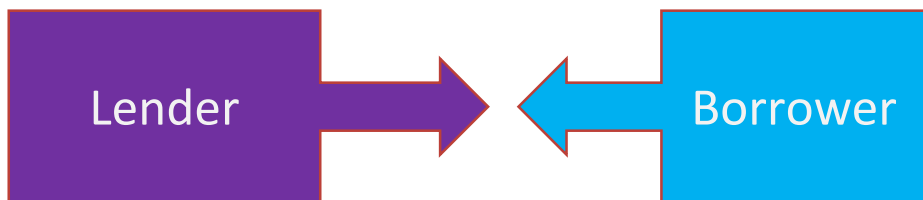
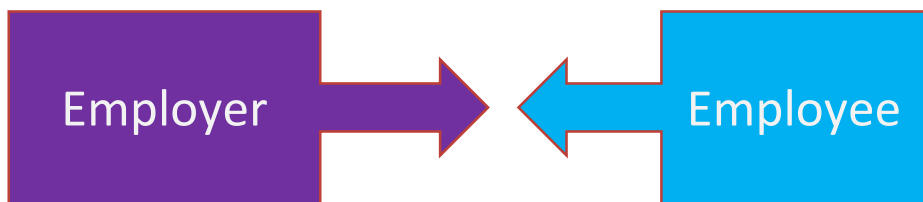
CORE's model of inflation

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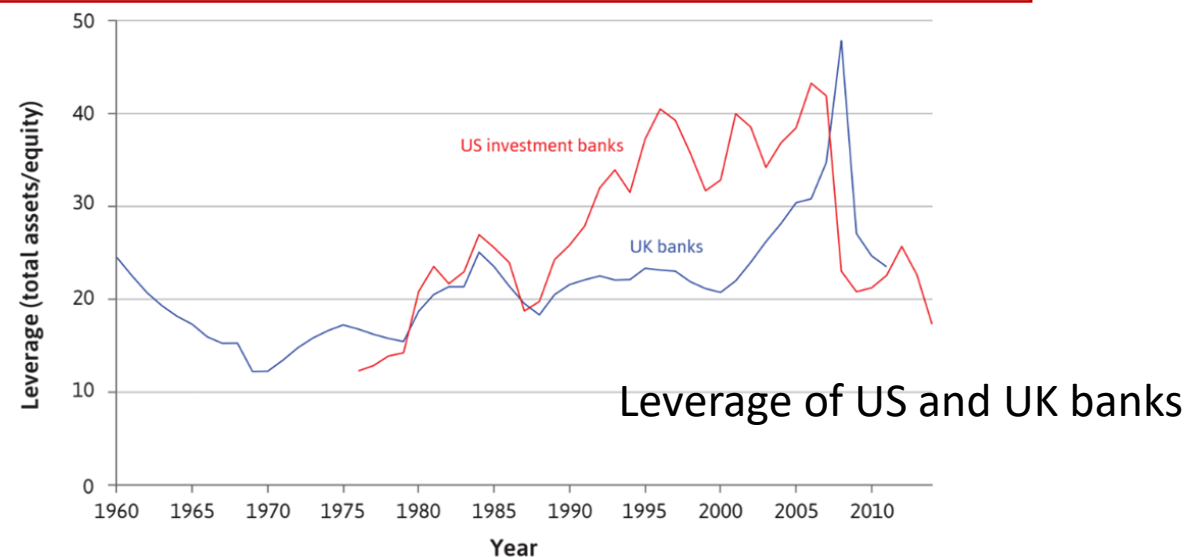
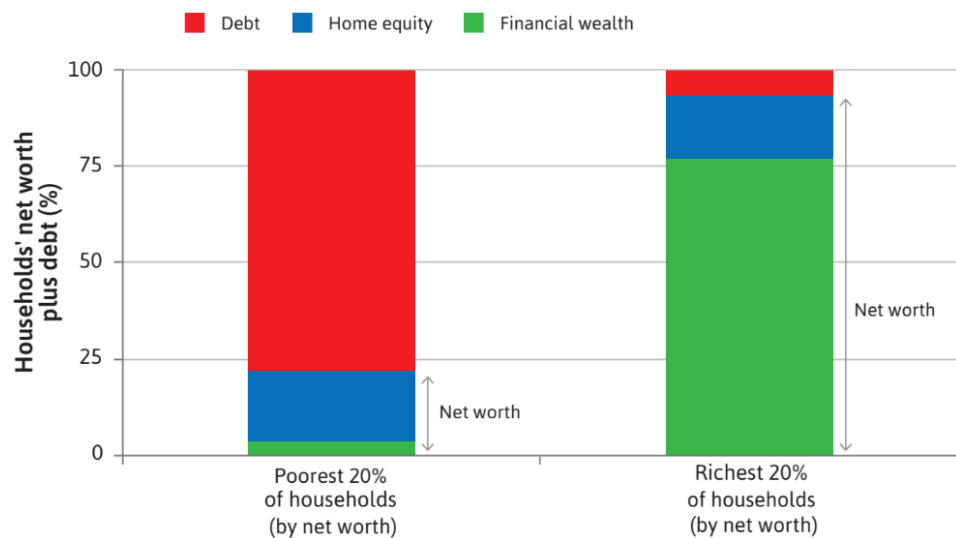
By Wendy Carlin, director, The CORE Project, Mon 30th October 2017 | [Blog](#) Employment at labour market equilibrium, inflation-stabilizing unemployment rate

We have received some questions about how the 'bargaining gap' model of inflation that we use in *The Economy* works. For example, Nick Rowe, a Professor of Economics at Carleton University in Ottawa, Canada, has asked why inflation would be lower in our model if a central bank targeted 2%, rather than 4% (our colleague Rajiv Sethi has preserved the Twitter conversation on Storify).

And a third principal-agent problem to analyze bank risk-taking



In both cases the agent has an incentive to take on **too much risk**
This is an **external effect** because the costs are borne by others (the principal)
→ Bank failures and the need for regulation



If the new problems and questions are at the front of the book there will have to be some changes in the **rest** of the book...examples.

Problems

- Wealth creation & growth
- **Environmental problems**
- Inequality
- Unemployment & fluctuations
- **Instability**

*Key concepts **new to Intro***

- Schumpeterian rents, disequilibrium
- Social interactions / other-regarding preferences
- Rents, bargaining power, institutions
- Incomplete contracts in labour & credit markets
- **Prices as information & dynamics of price-setting**

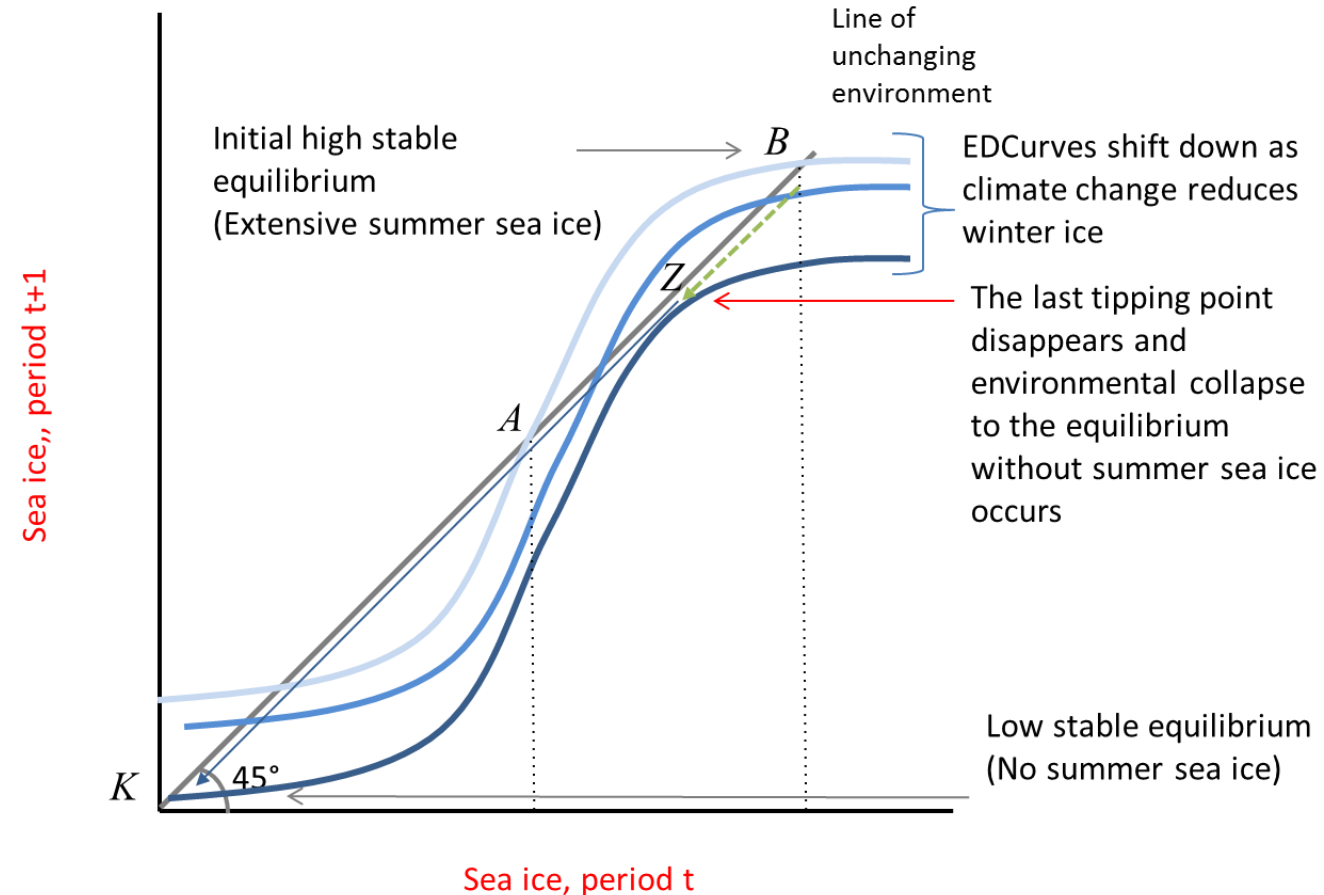
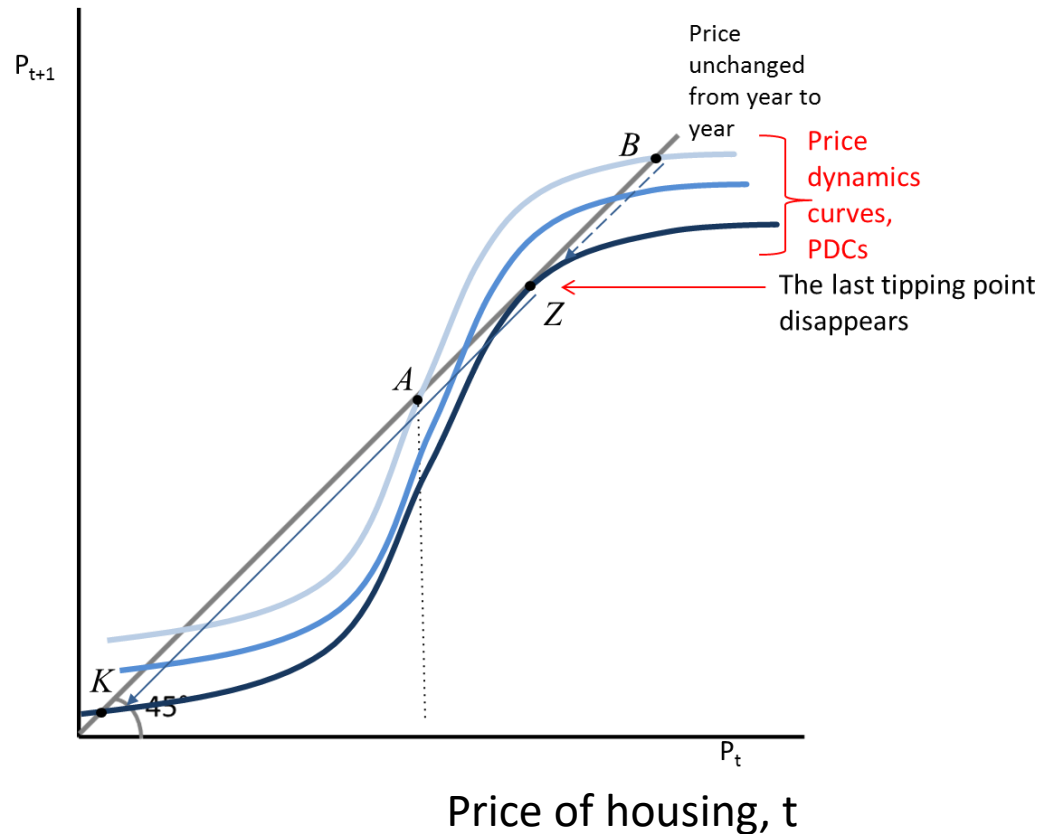
Learn tools that can be applied to different problems in the real world

A bubble in the housing market

An environmental tipping point

Figure 20.24. Climate change and irreversible loss of summer Arctic sea ice.

A tipping point in the housing market.



A paradigm in economics has to take a position on

Benchmark

- What the economy is
- What people are like

Econ 101

Static, self-contained system

Homo economicus

CORE, and contemporary economics

- How we interact in the economy

Perfectly competitive markets

- The economic outcomes of these interactions

Static and 'optimal'

- How these are to be evaluated

Unexploited mutual gains

- How they may be improved by public policy

Limited to narrowly defined market failures

A paradigm in economics has to take a position on

Benchmark

- What the economy is
- What people are like
- How we interact in the economy
- The economic outcomes of these interactions
- How these are to be evaluated
- How they may be improved by public policy

Econ 101

Static, self-contained system

Homo economicus

Perfectly competitive markets

Static and 'optimal'

Unexploited mutual gains

Limited to narrowly defined market failures

CORE, and contemporary economics

Always-changing process embedded in society & biosphere

Also, have social preferences, respond to norms; are principals and agents

Also, price-making, strategic and non-market interactions associated with static & dynamic economic rents

Include dynamic responses and pervasive external effects

Also, fairness

Of central concern

Back to problems, paradigms and texts: Samuelson incorporates aggregate demand



Aggregate demand

Samuelson 1948
= Marshall + Keynes

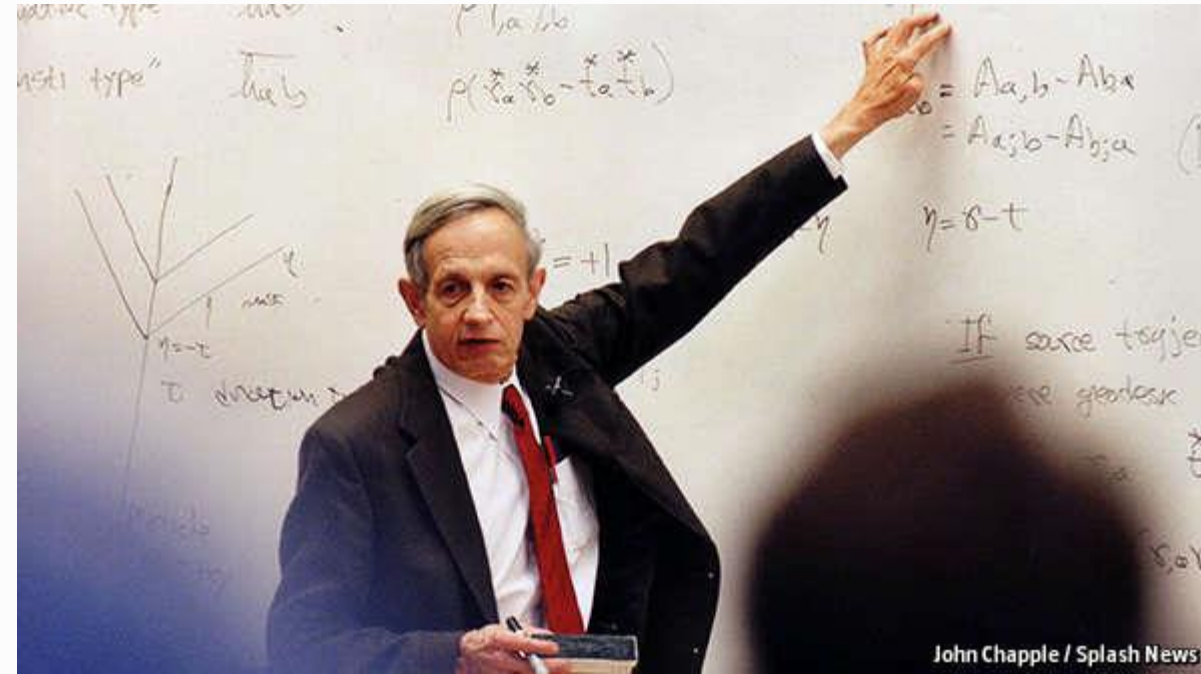
Strategic interaction

Information is scarce and local

Back to: Problems, paradigms and texts



Aggregate demand



Strategic interaction

John Nash



Information is scarce and local

Friedrich Hayek

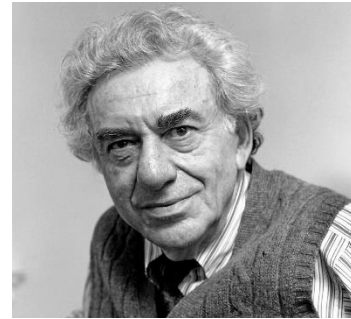
Back to: Problems, paradigms and texts – integrating insights



The entrepreneur, creative destruction

Joseph Schumpeter

The Economy Units 2, 16, 21



Instability and risk

Hyman Minsky

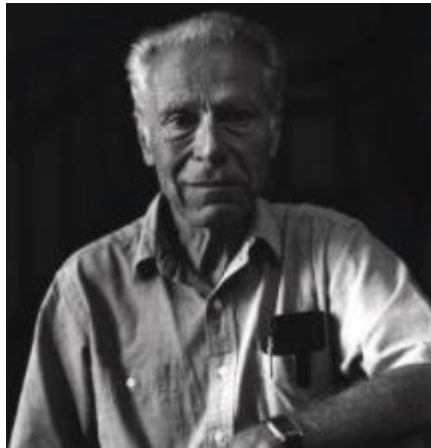
The Economy Units 10, 17



Power, human motivation and organizations

Herbert Simon

The Economy Units 4, 5, 6, 20, 22



Exit, voice, and loyalty in the economy, society & politics

Albert Hirschman

The Economy Unit 22



Social norms and managing common property

Elinor Ostrom

The Economy Units 4, 12, 20

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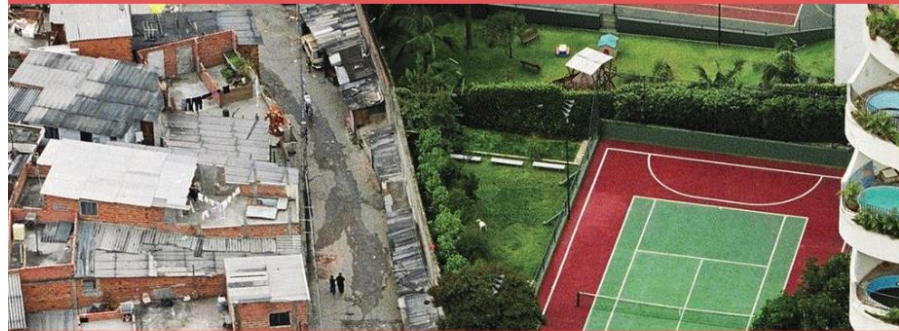
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Undergrad or public policy masters

Hands-on step-by-step data handling
and analysis projects
Using Excel or R
Linked to ESPP (& The Economy)

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THE ECONOMY

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THE CORE ESPP TEAM

ECONOMY, SOCIETY, AND PUBLIC POLICY **BETA**

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Working in Excel
Working in R

2 Collecting and analysing data from experiments

Learning objectives
Introduction
Working in Excel
Working in R

3 Measuring the effect of a sugar tax

Learning objectives
Introduction
Working in Excel
Working in R

4 Measuring wellbeing

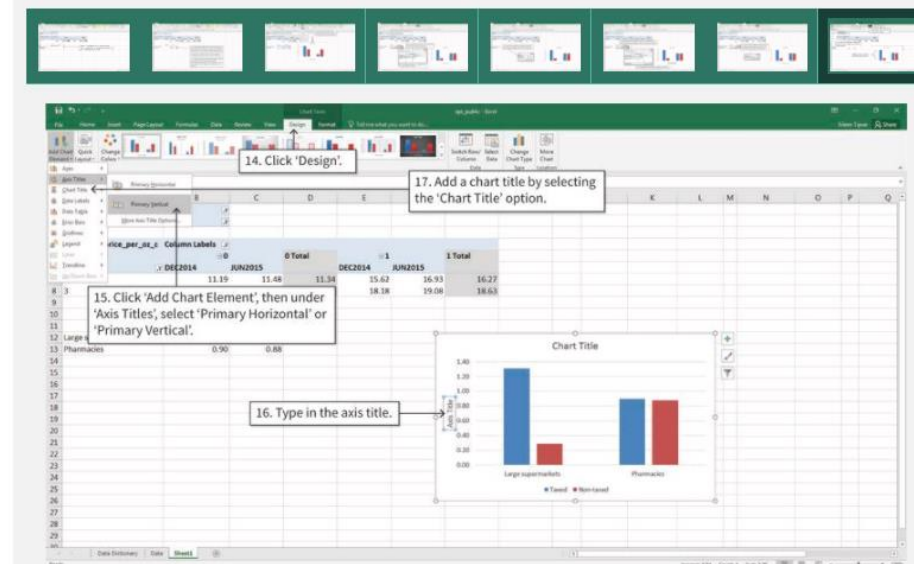
Learning objectives
Introduction
Working in Excel
Working in R

5 Measuring inequality

Learning objectives
Introduction
Working in Excel
Working in R

WALK-THROUGH 3.3

Making a column chart to compare two groups



Add axis titles and a chart title

After step 17, your chart will look like the bottom chart of Figure 2 in the journal paper.

Figure 3.5 How to make a column chart to compare two groups.

THE CORE ESPP TEAM

ECONOMY, SOCIETY, AND PUBLIC POLICY **BETA**

Read now



1—Capitalism: affluence, inequality, and the environment

2—Social interactions and economic outcomes

3—Public policy for fairness and efficiency

4—Work, wellbeing, and scarcity

5—Institutions, power, and inequality

6—The firm: Employees, managers, and owners

7—Firms and markets for goods and services

8—The labour market: Wages, profits, and unemployment

9—The credit market: Borrowers, lenders, and the rate of interest

10—Banks, money, housing, and financial assets

11—Market failures and government policy

12—Governments and markets in a democratic society

3 Public policy for fairness and efficiency

Introduction

3.1 Goals of public policy

3.2 Fairness and efficiency in the ultimatum game

3.3 Evaluating institutions and outcomes: Is it efficient?

3.4 Evaluating institutions and outcomes: Is it fair?

3.5 What's wrong with inequality? Procedural and substantive judgements of fairness

3.6 Implementing public policies

3.7 Unintended consequences: Policies affect preferences

3.8 Unintended consequences of a redistributive tax

3.9 How do we find out if a policy will work?

3.10 Economic models: How to see more by looking at less

3.11 Conclusion

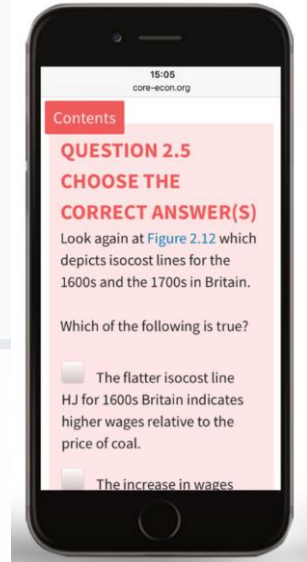
3.12 Doing Economics: Empirical Project 3

3.13 References

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Barnard College, Columbia University



The Econ 101 paradigm is broken – what is the alternative?



Azim Premji
University,
Bangalore



Yann Algan
CORE-Sciences Po, Paris



Antonio Cabrales CORE-UCL

Wendy Carlin, UCL and CORE
Slovak Economic Association Meeting (SEAM) 2018
Keynote Lecture
September 2018