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FINANCIAL TIMES

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PortfolioMy Account

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

f

in

Save

Tom Clark and Chris Giles APRIL 24, 2018

275

Yes — outdated frameworks still inform policy prescriptions

Prospect

Think again. Think Prospect

POLITICSECONOMICS & FINANCEWORLDARTS & BOOKSLIFE

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

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BOOKSLIFE

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

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in

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



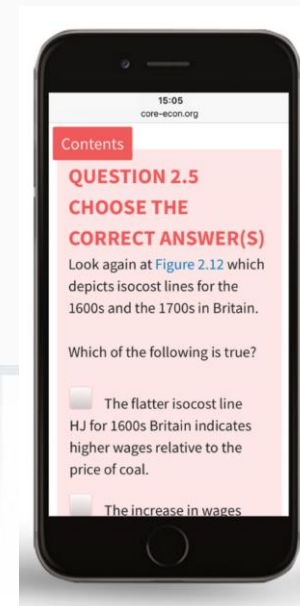
**core  
econ**

Free online,  
go to [www.core-econ.org](http://www.core-econ.org)



Belinda Archibong, CORE-USA  
Barnard College, Columbia University

Welcome to the  
**CORE USA**  
Workshop  
**2017**



**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  
Irish Economic Association Conference 2018  
ESR Guest Lecture  
May 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**  
University of Manchester



**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**  
University of Oxford



**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.



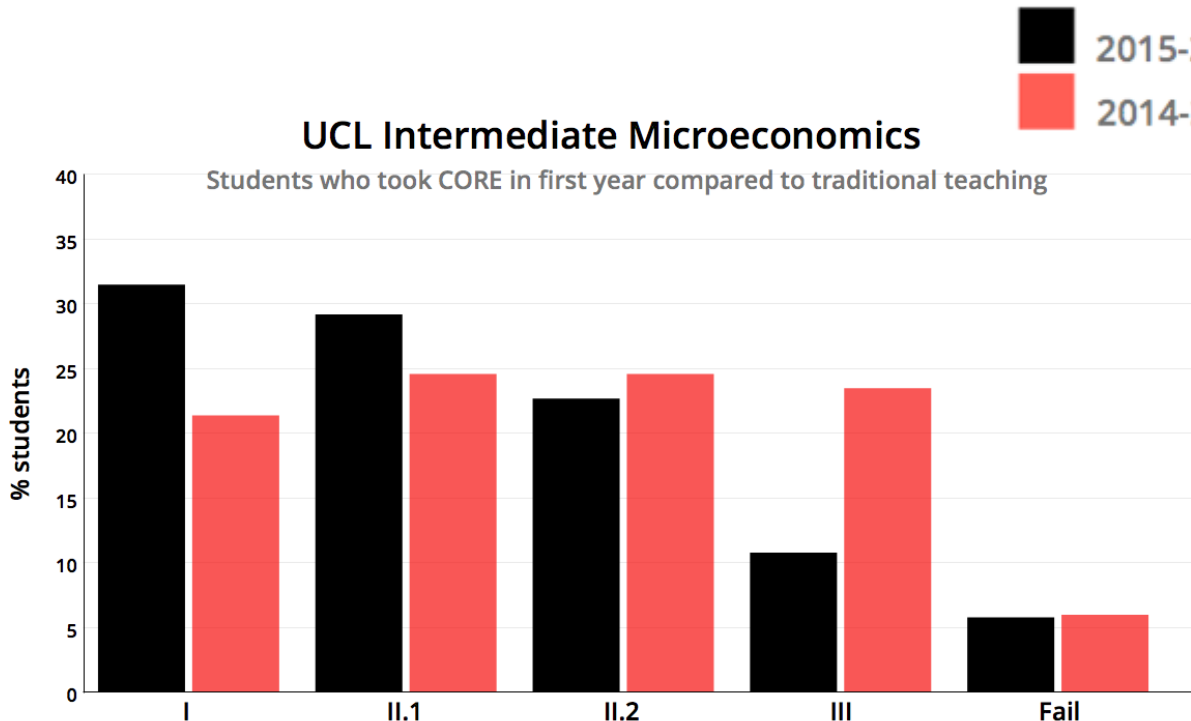


# Does it work? UCL replaced 'ECON101' by CORE for all BSc Econ students in 2014

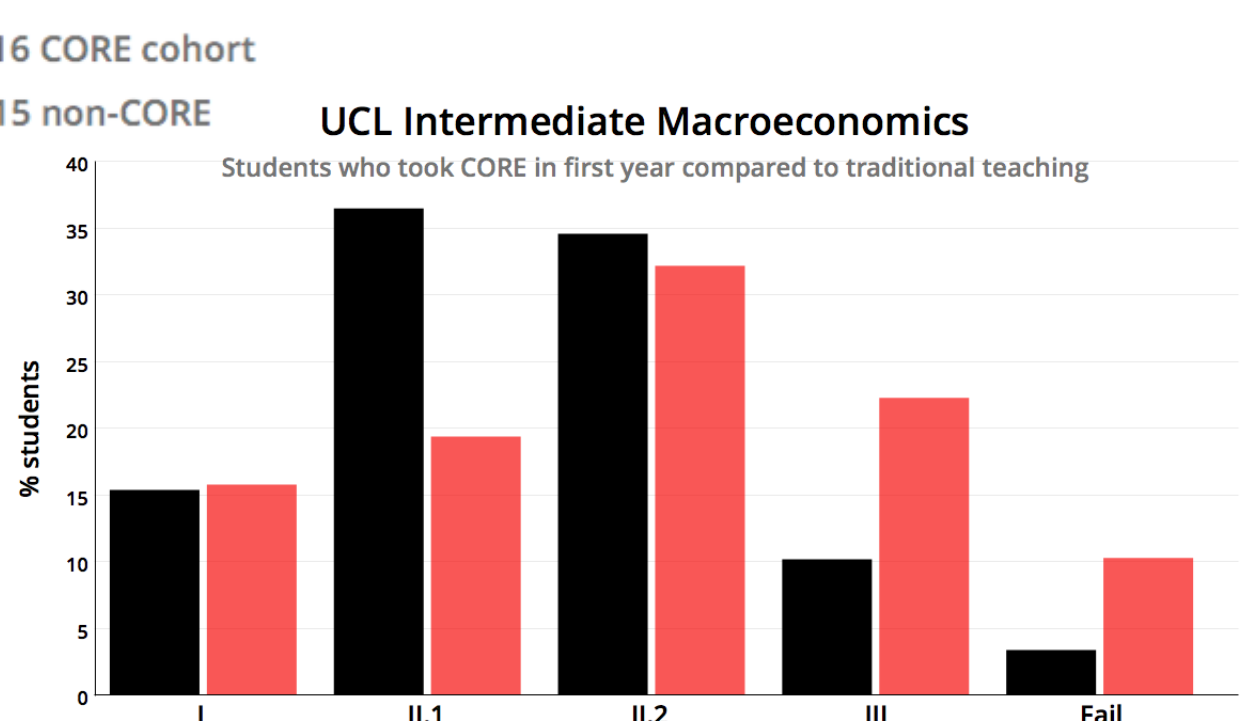
Examination results in 2016 of the first CORE cohort in their conventional **second year** intermediate micro and macro exams:

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**



First class (distinction) .....Fail

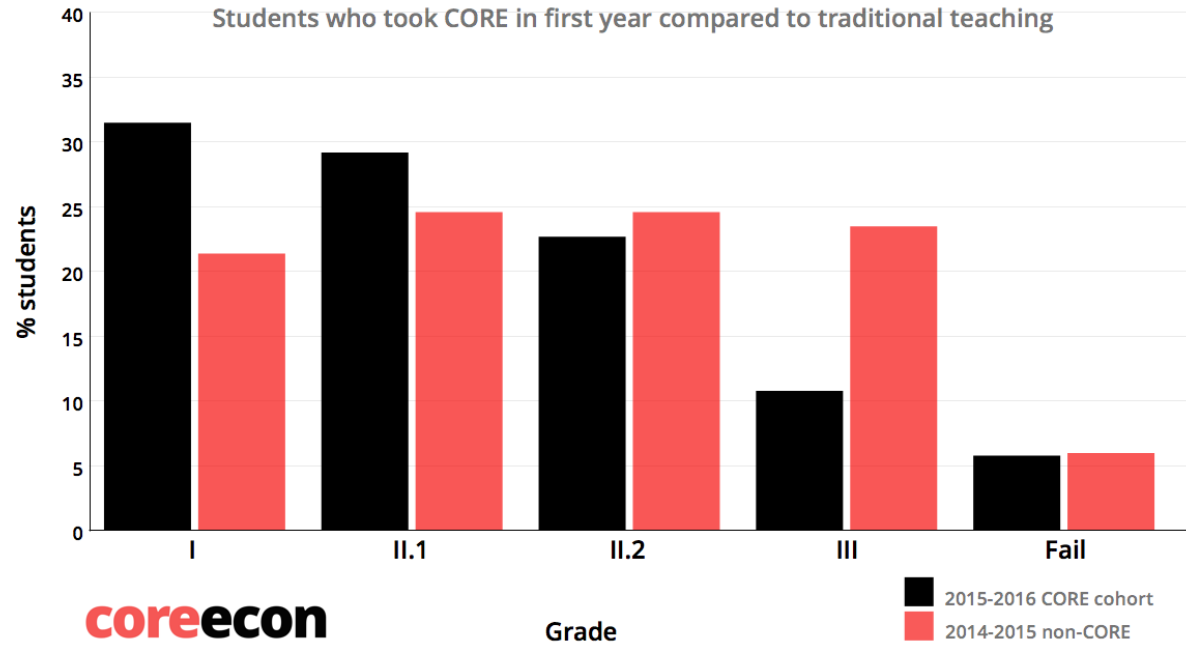


First class (distinction) .....Fail



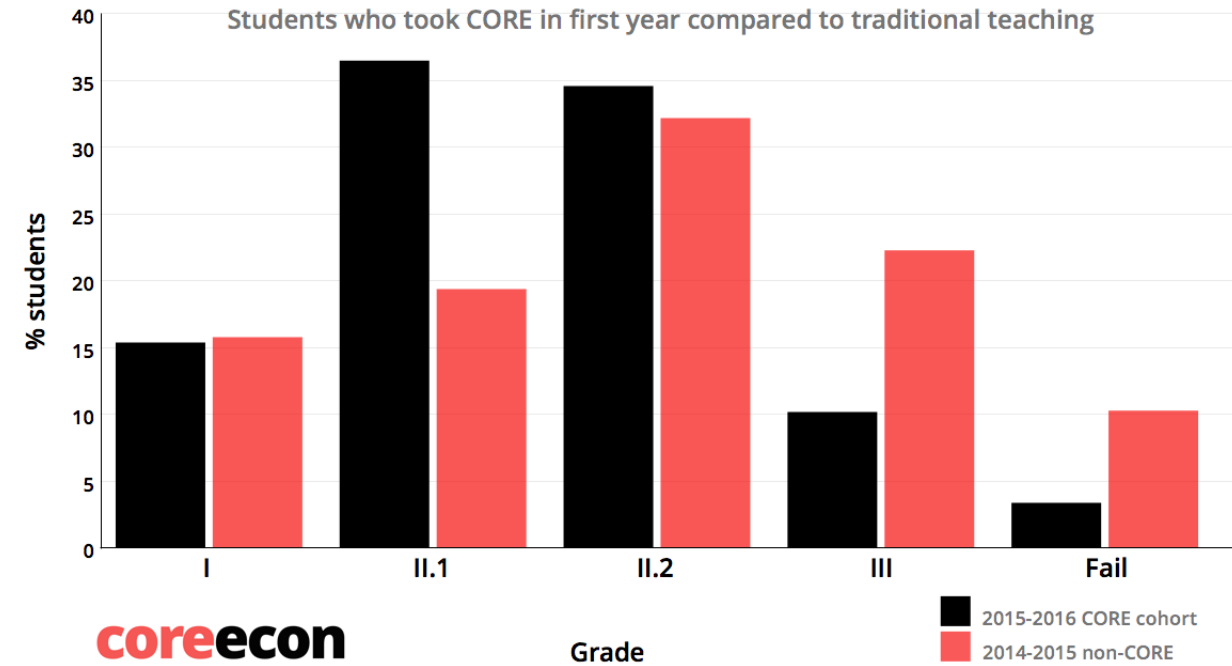
## UCL Intermediate Microeconomics

Students who took CORE in first year compared to traditional teaching



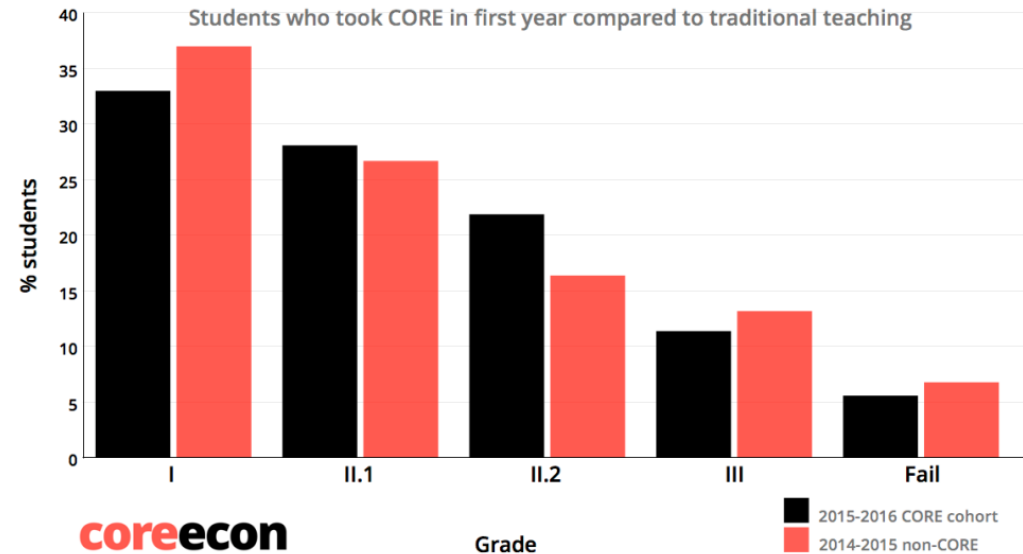
## UCL Intermediate Macroeconomics

Students who took CORE in first year compared to traditional teaching



## UCL Intermediate Econometrics

Students who took CORE in first year compared to traditional teaching



Just better  
students that  
year?

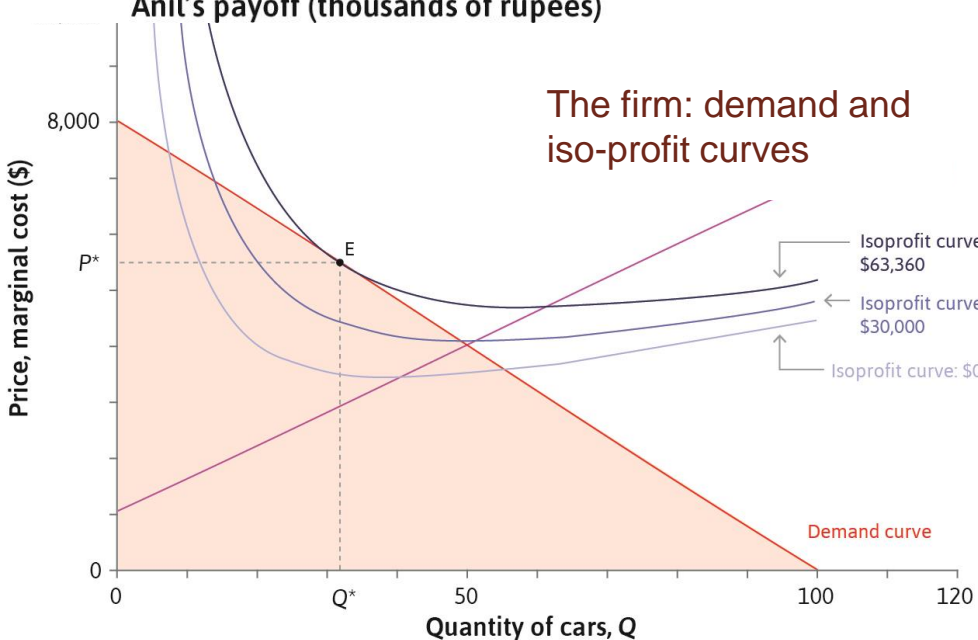
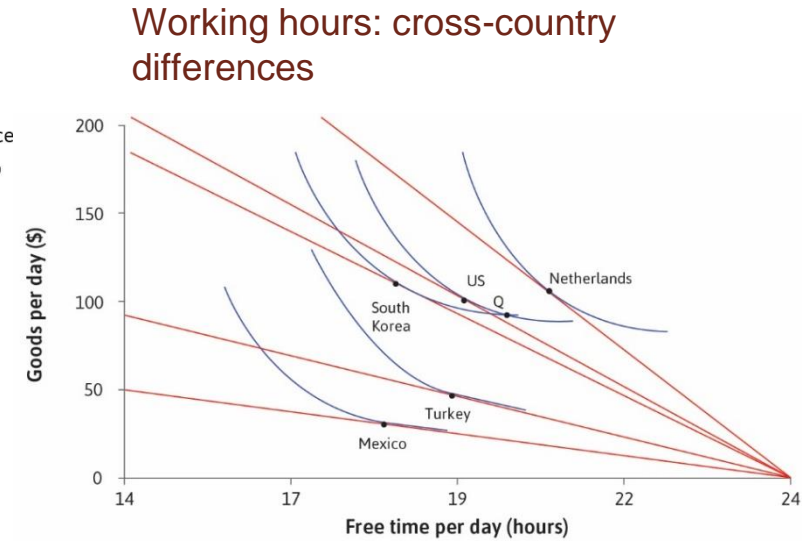
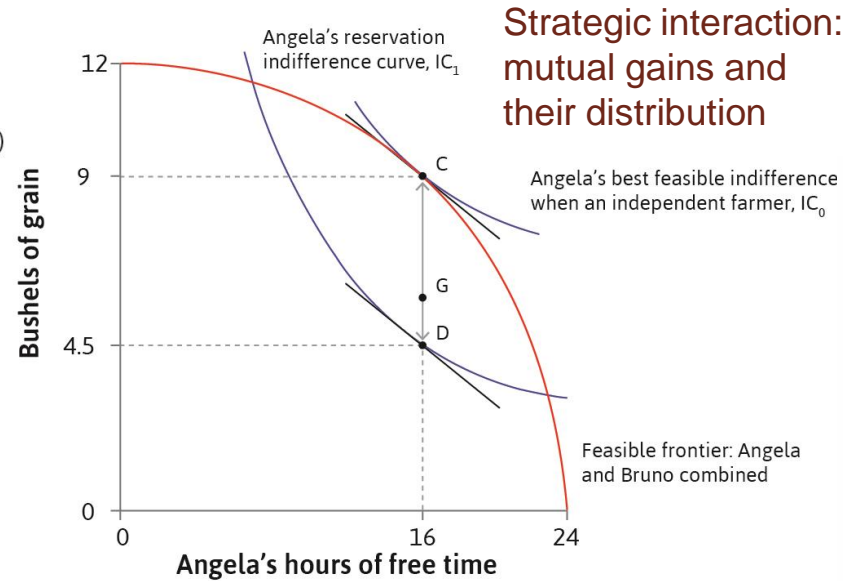
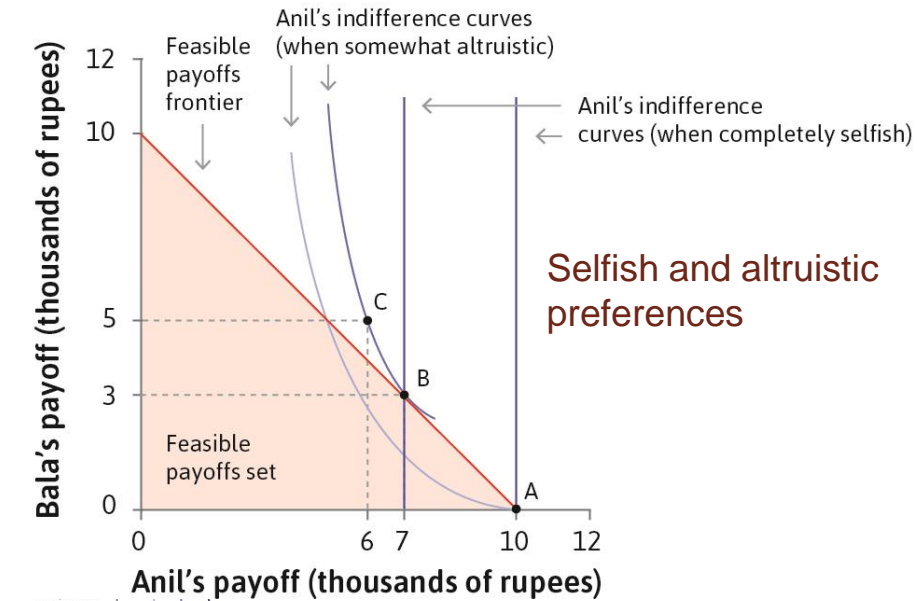
What could  
explain this?

2015-2016 CORE cohort  
2014-2015 non-CORE



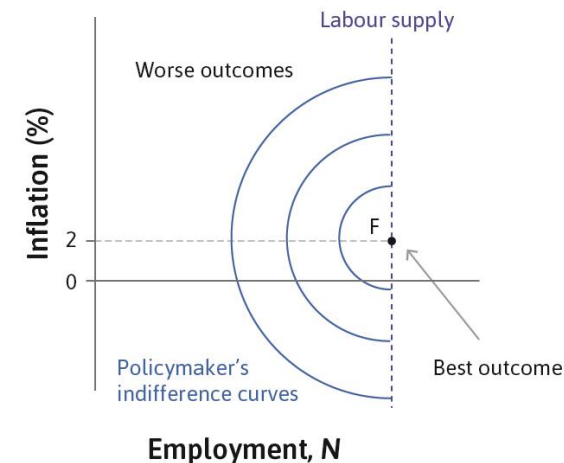
# Why does it work? Teaching the tools of economics – feasible sets and preferences

## – motivated by and applied to real problems in the world

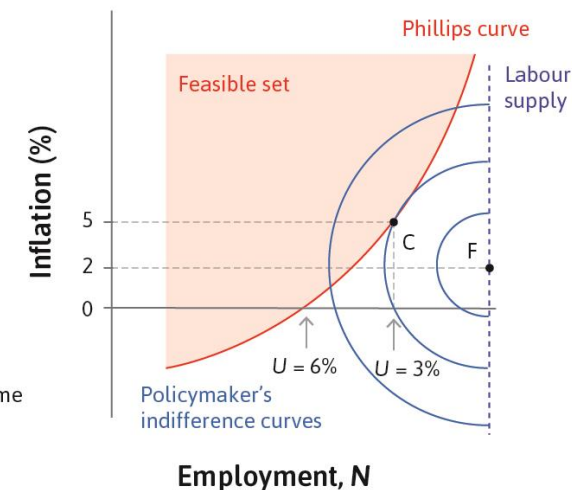


### The macroeconomic policy maker

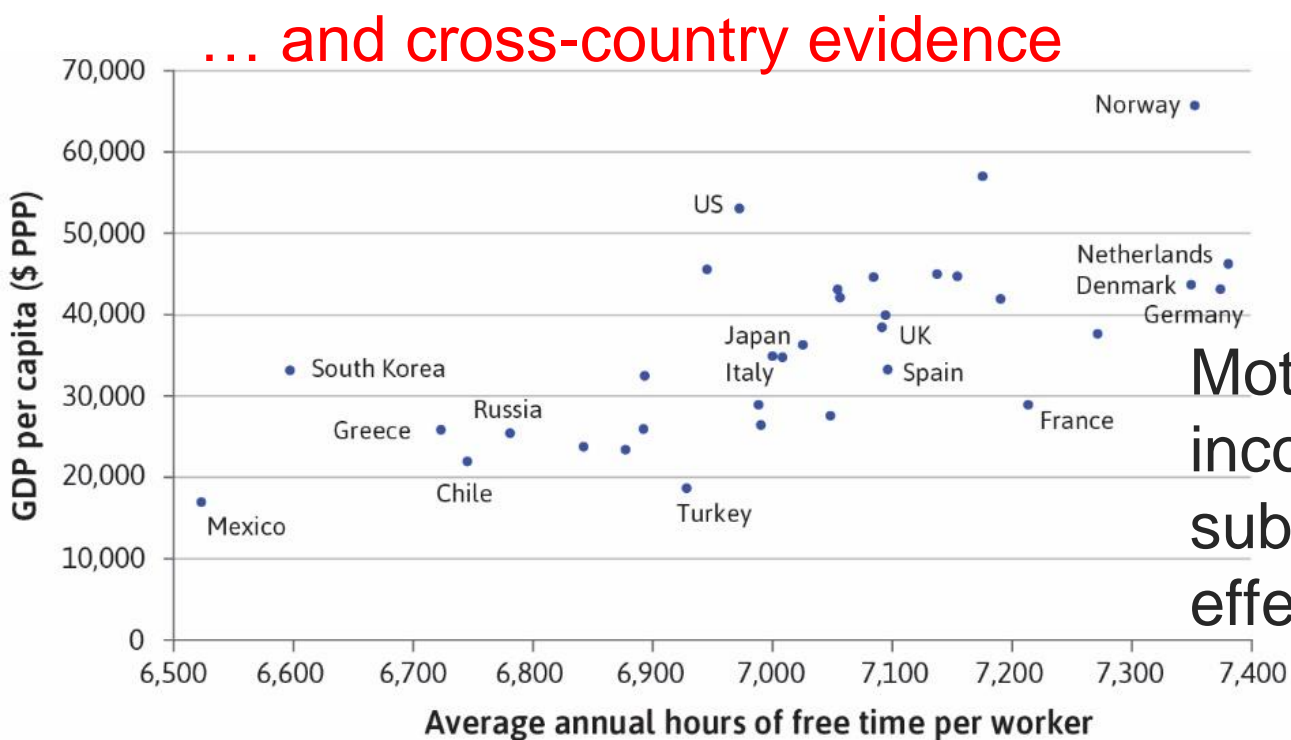
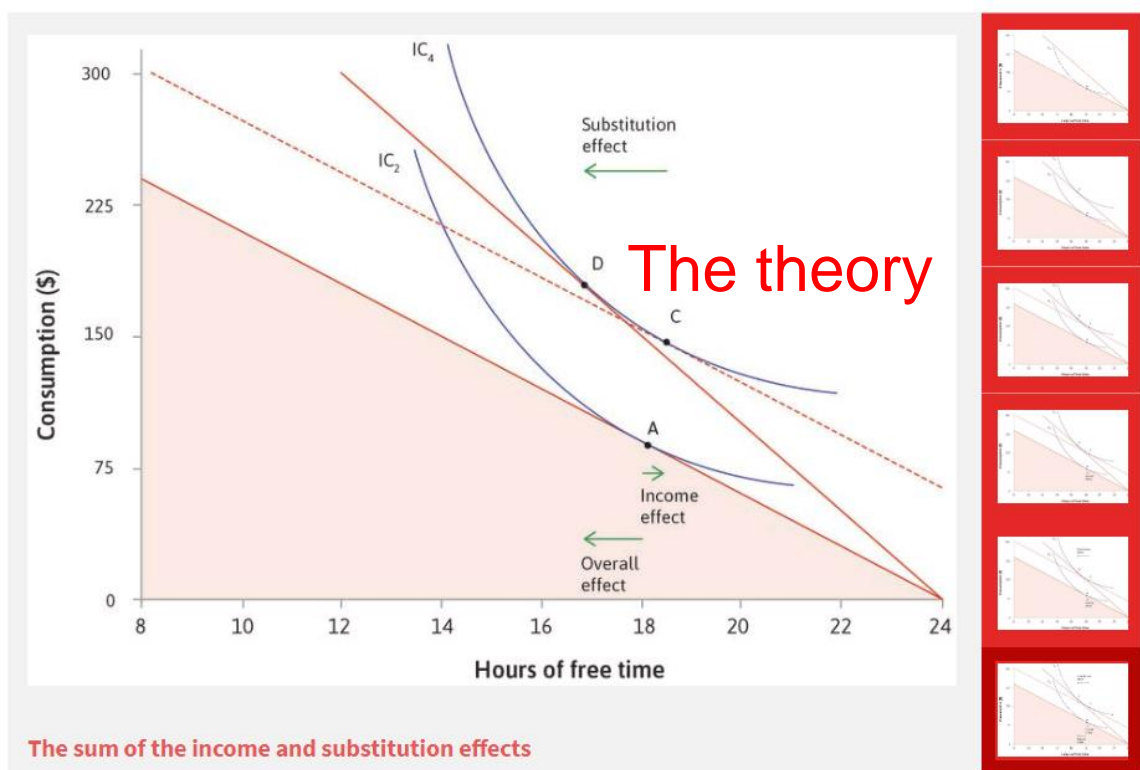
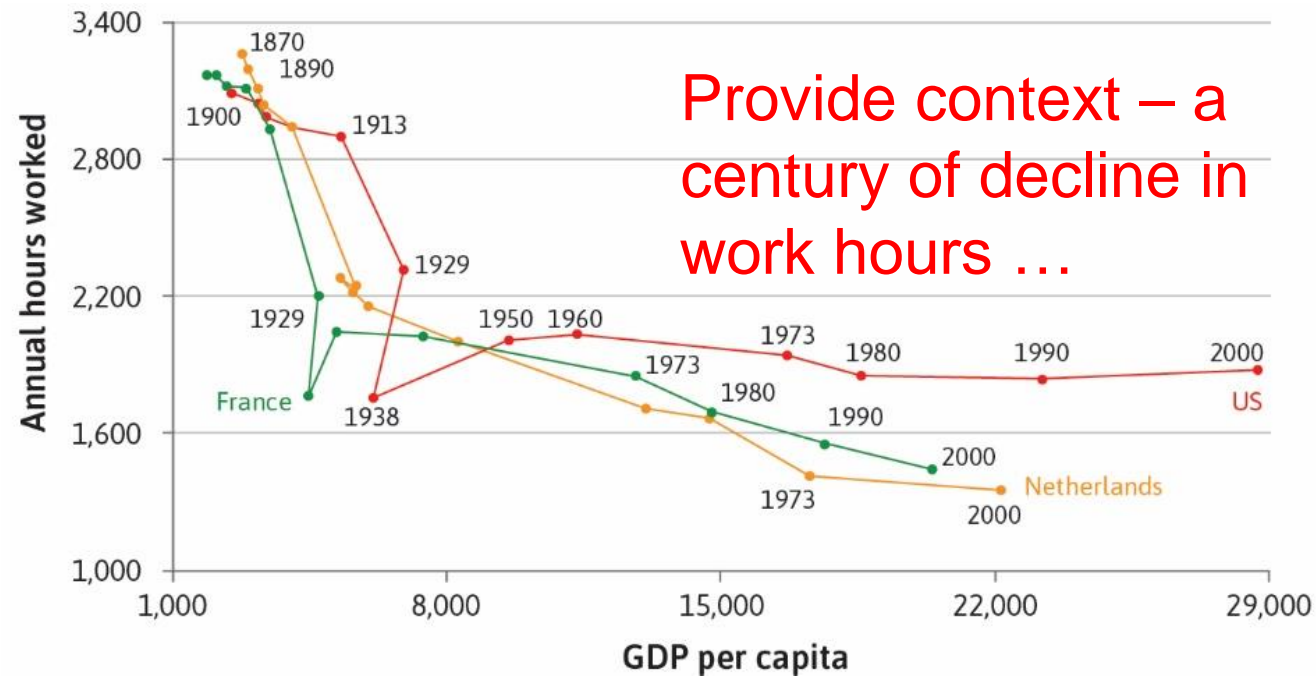
#### The policymakers' preferences



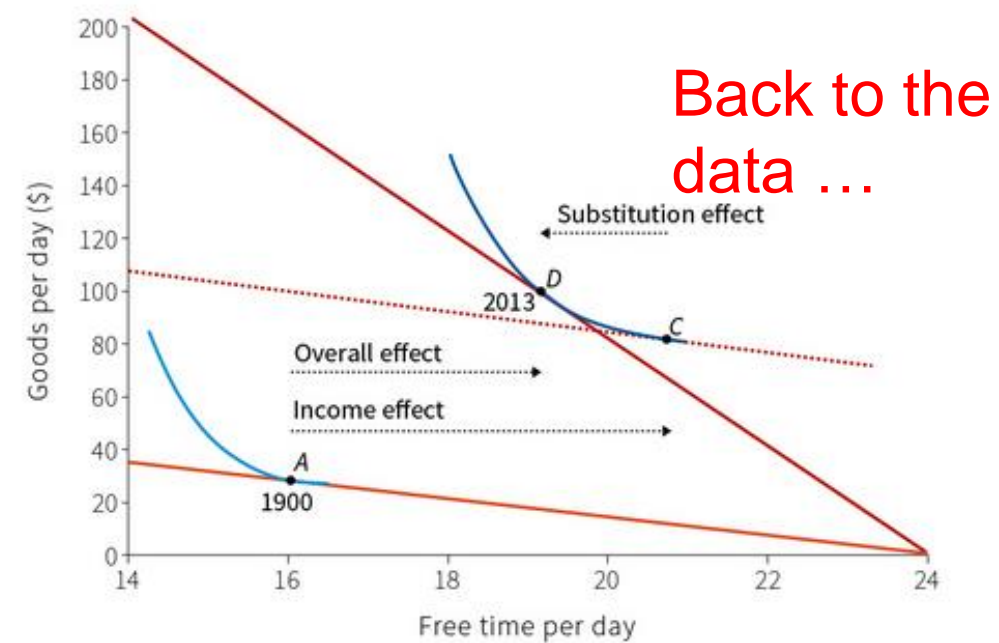
#### The policymakers' preferences and the Phillips curve trade-off







Motivate income and substitution effects



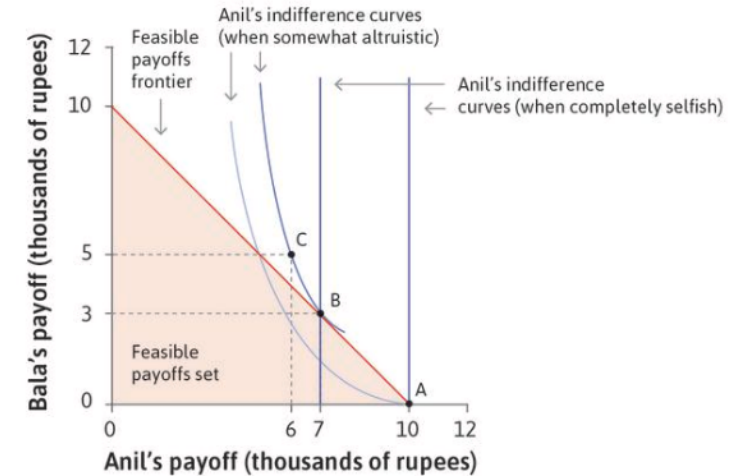


# Why does it work? Developing mathematical understanding in the context of economic problems

## 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  $\alpha$  and  $\beta$  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



# Motivation and role models



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?



U. de los Andes, Bogota

ar students  
m 2016

peace  
inequality  
economic crisis  
politics  
future  
sustainability  
digitalisation  
poverty  
capitalism  
climate change  
energy  
basic income  
growth  
international monetary system  
demographic change  
equal pay  
pension  
tax

Humboldt University, Fall 2016

inequality  
brexit  
immigration  
scarce resources  
climate change  
hunger  
global warming  
migration  
slowing economic growth  
environment  
growth  
efficiency  
global poverty  
peace  
global growth slowdown  
growing populations

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



# Inequality



A word cloud of various economic and social issues, with 'Inequality' as the largest word at the top. Other prominent words include 'Brex'it', 'Global Warming', 'Globalisation', 'Poverty', 'Financial Crises', 'Productivity Puzzle', and 'Population Growth'. The words are arranged in a horizontal, somewhat chaotic manner, with some words appearing vertically or at an angle. The colors of the words range from dark red to light yellow.

Secular Stagnation  
Low Growth  
Social Welfare  
Old Theory  
Consumer Preferences  
Increasing Population  
Inflation  
Technology  
Irregular Policies  
Globalisation  
Poverty  
Global Warming  
Bubbles  
Income Inequality  
Sustainable Development  
Climate Change  
Economic Growth  
Too Big To Fail  
Financial Crises  
Low Interest Rates  
Influence Technology  
Methodology  
Stability  
Absolute Poverty  
Productivity Growth  
Productivity  
Wealth Disparity  
Global Inequality  
Diversity  
Promoting Opportunity  
Predicting Future  
Wage Growth  
Robots  
Growth  
Population Growth  
Ineffective Central Bank Policy  
Opportunities Everyone  
Technological Unemployment  
Credit Cycle



# 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 little in the half century since Samuelson.
- CORE represents a new paradigm based on different first principles and addressed to 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

## Econ 101

Static, self-contained system

*Homo economicus*

Perfectly competitive markets

## CORE, and contemporary economics

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

Static and 'optimal'

Unexploited mutual gains

Limited to narrowly defined market failures

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

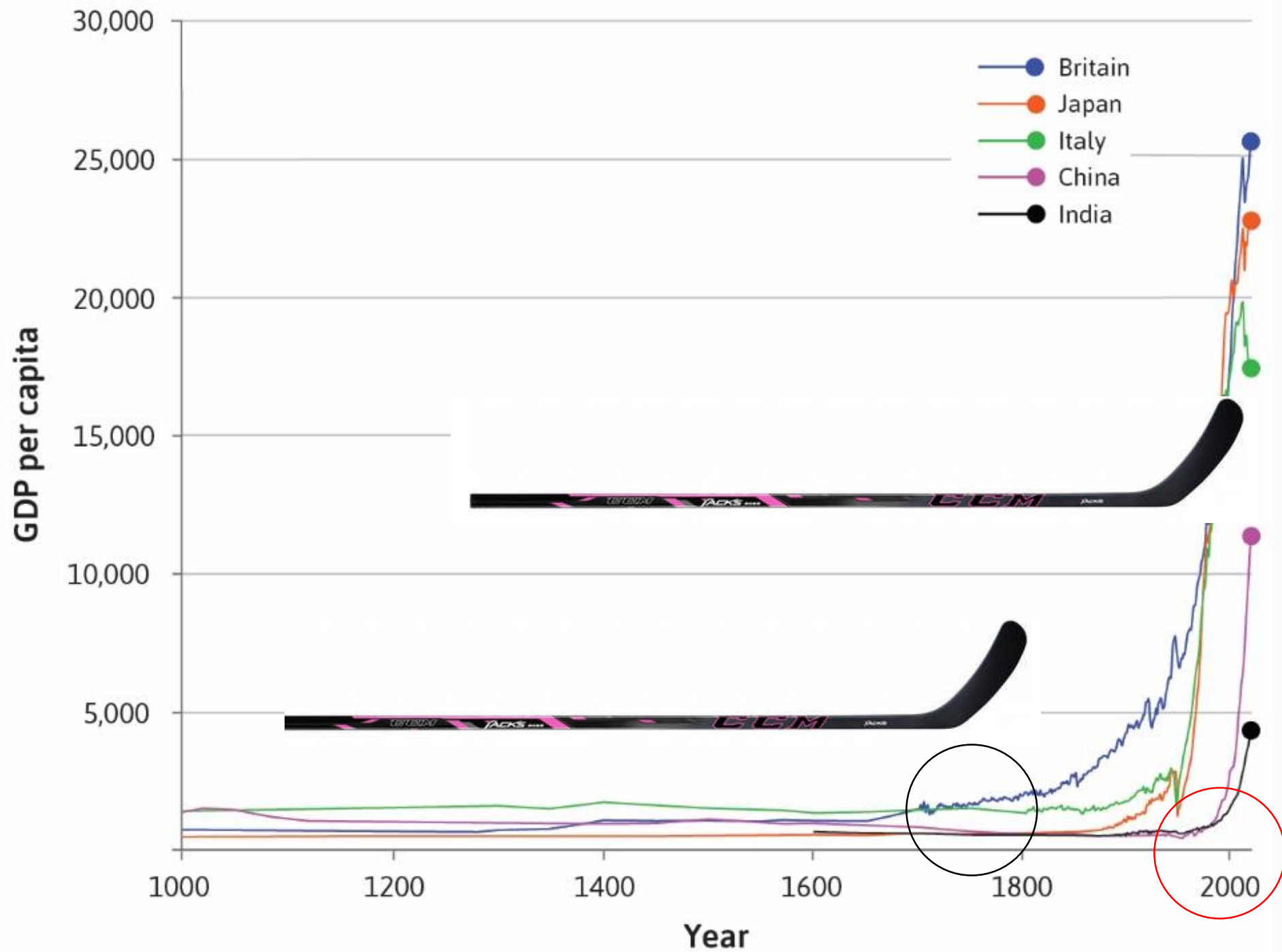
How capitalism revolutionized the way we live, and how economics attempts to understand this and other economic systems

- 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



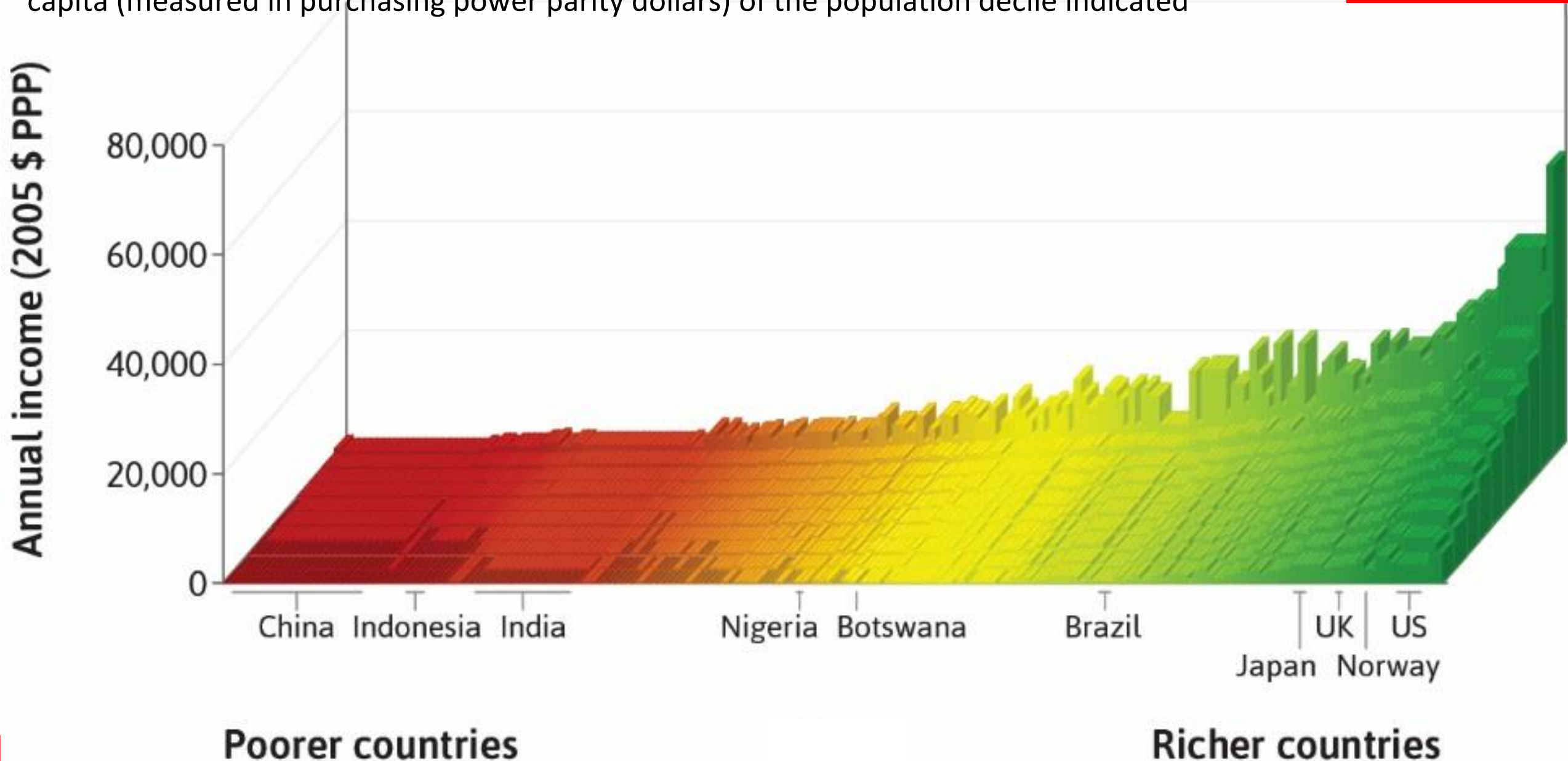




One of the first figures the student sees in CORE (and can [manipulate](#))

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

Indonesia

Nigeria

China

Botswana

Brazil

UK

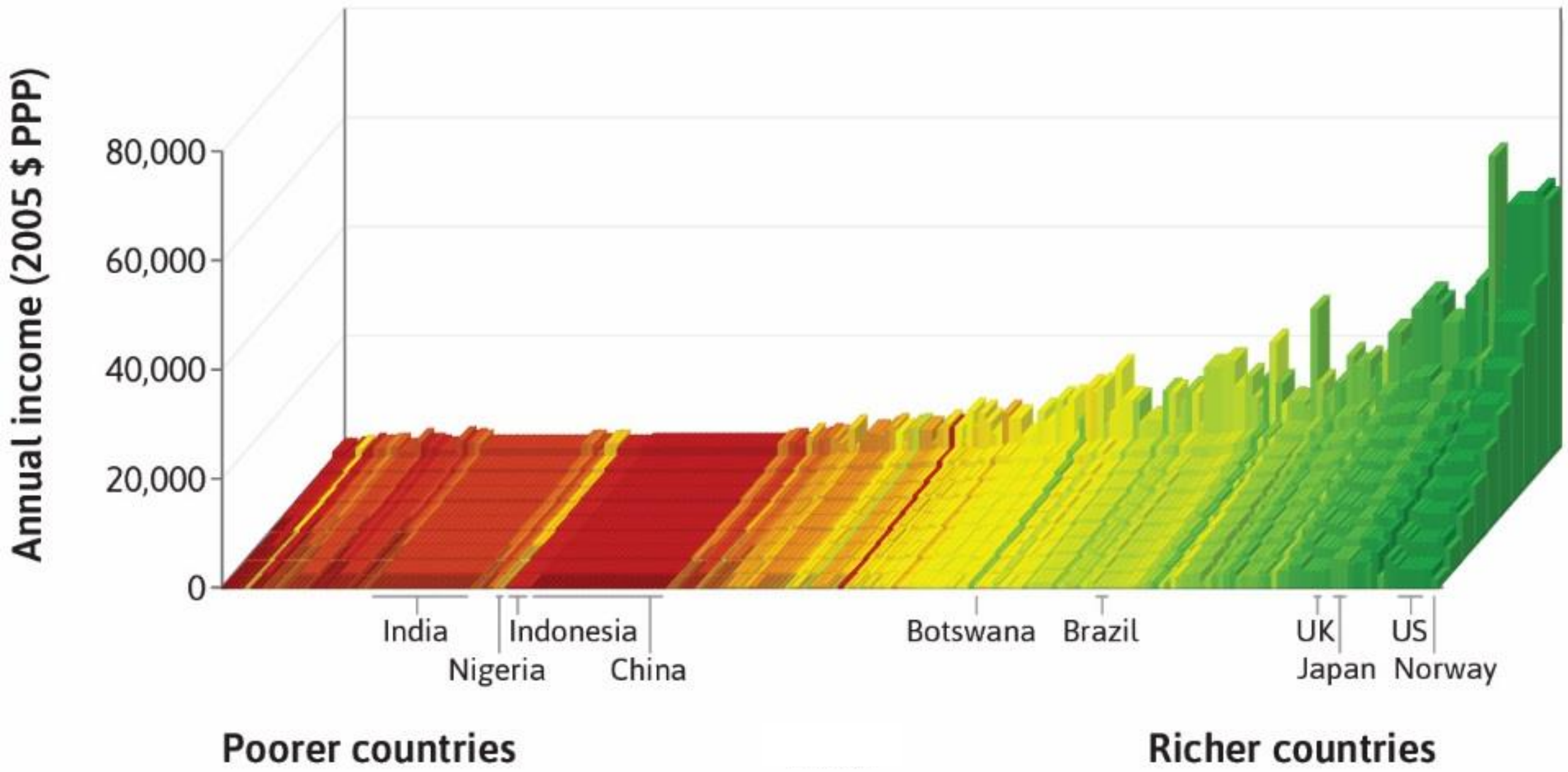
Japan

US

Norway

Poorer countries

Richer countries





2014

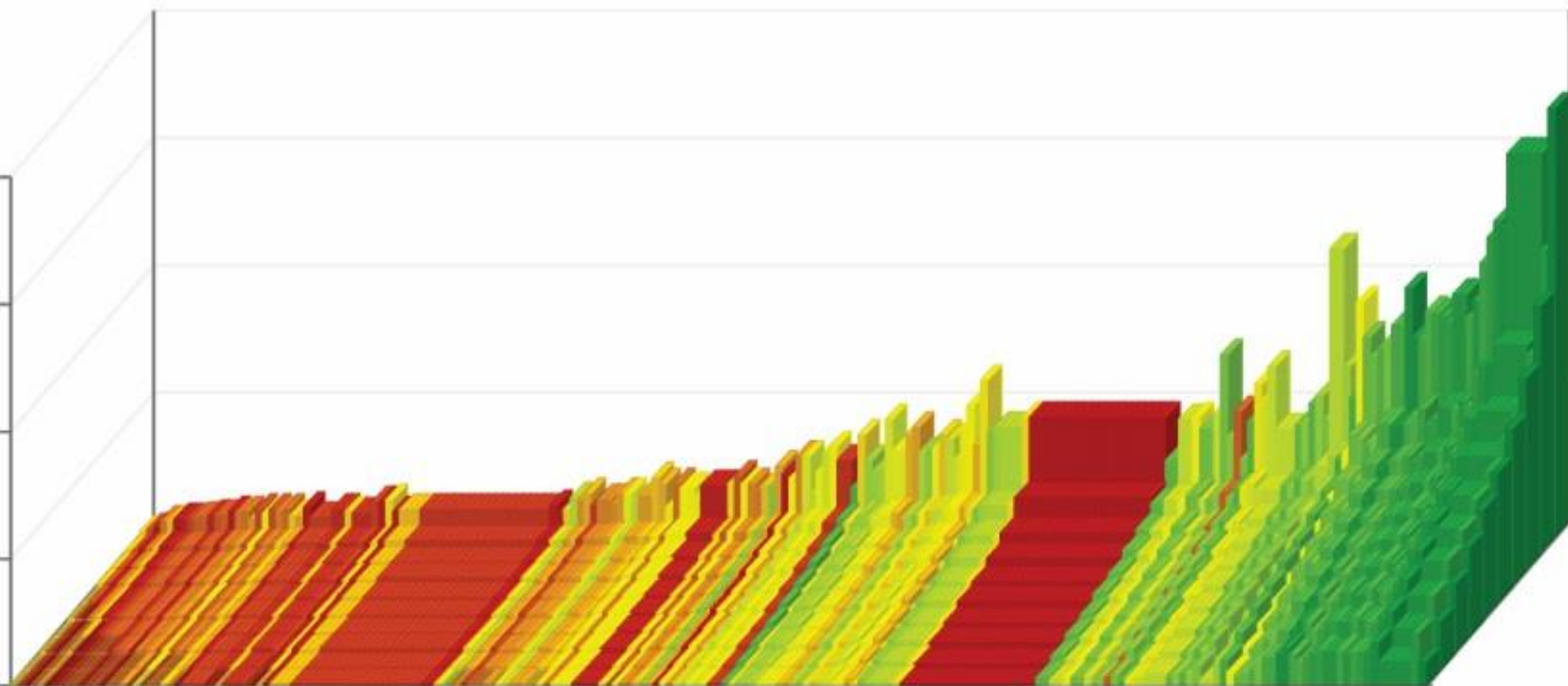
Annual income (2005 \$ PPP)

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

India Indonesia Botswana China Japan US  
Nigeria Brazil UK Norway

Poorer countries

Richer countries





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



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**
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## 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

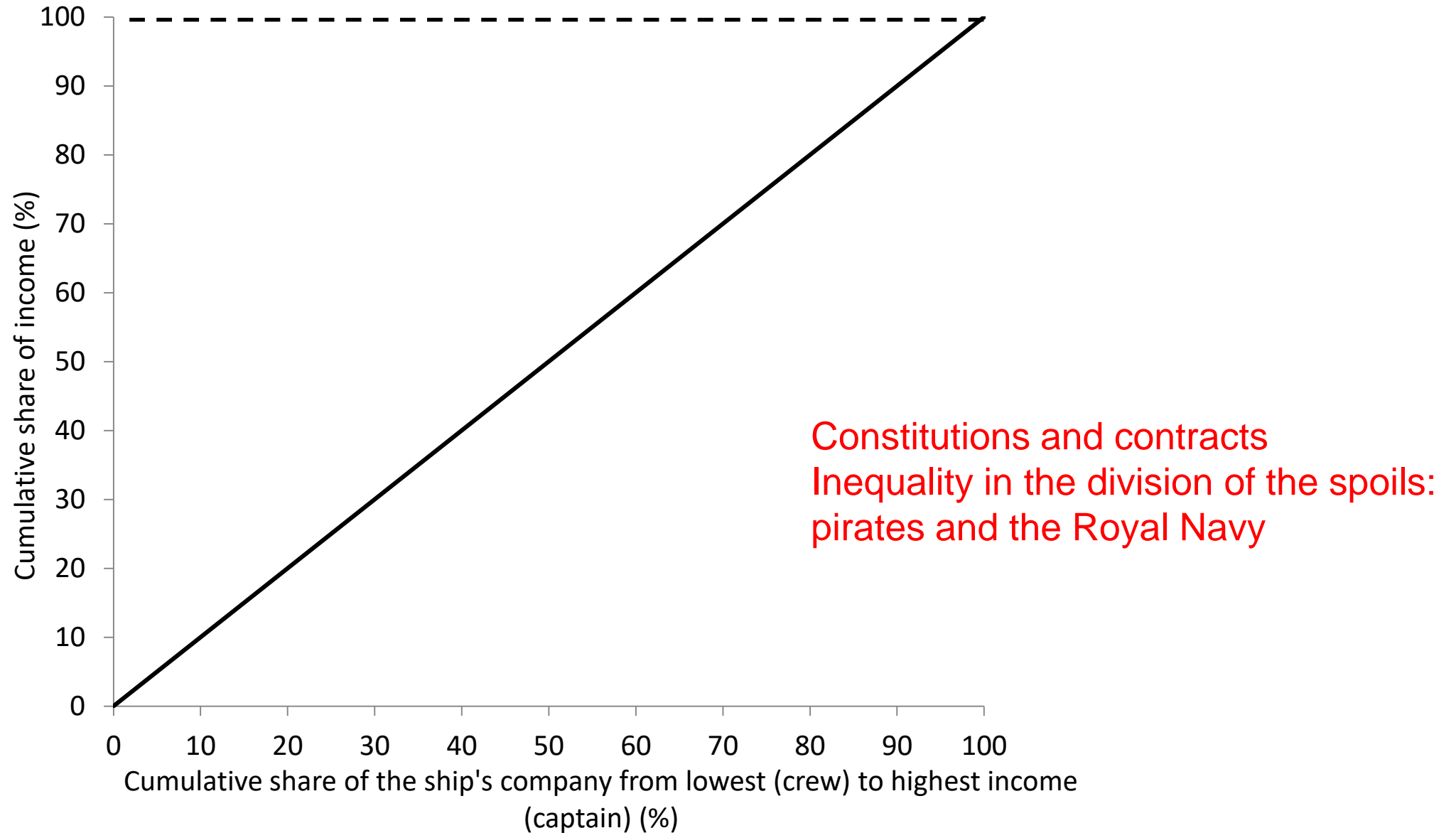
*The Captain and Quarter Master to receive two Shares of a Prize (the booty from a captured ship); the Master, Boatswain, and Gunner one Share and a half, and other Officers one and a Quarter (everyone else to receive one share, called his Dividend.)*

#### ARTICLE XI

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



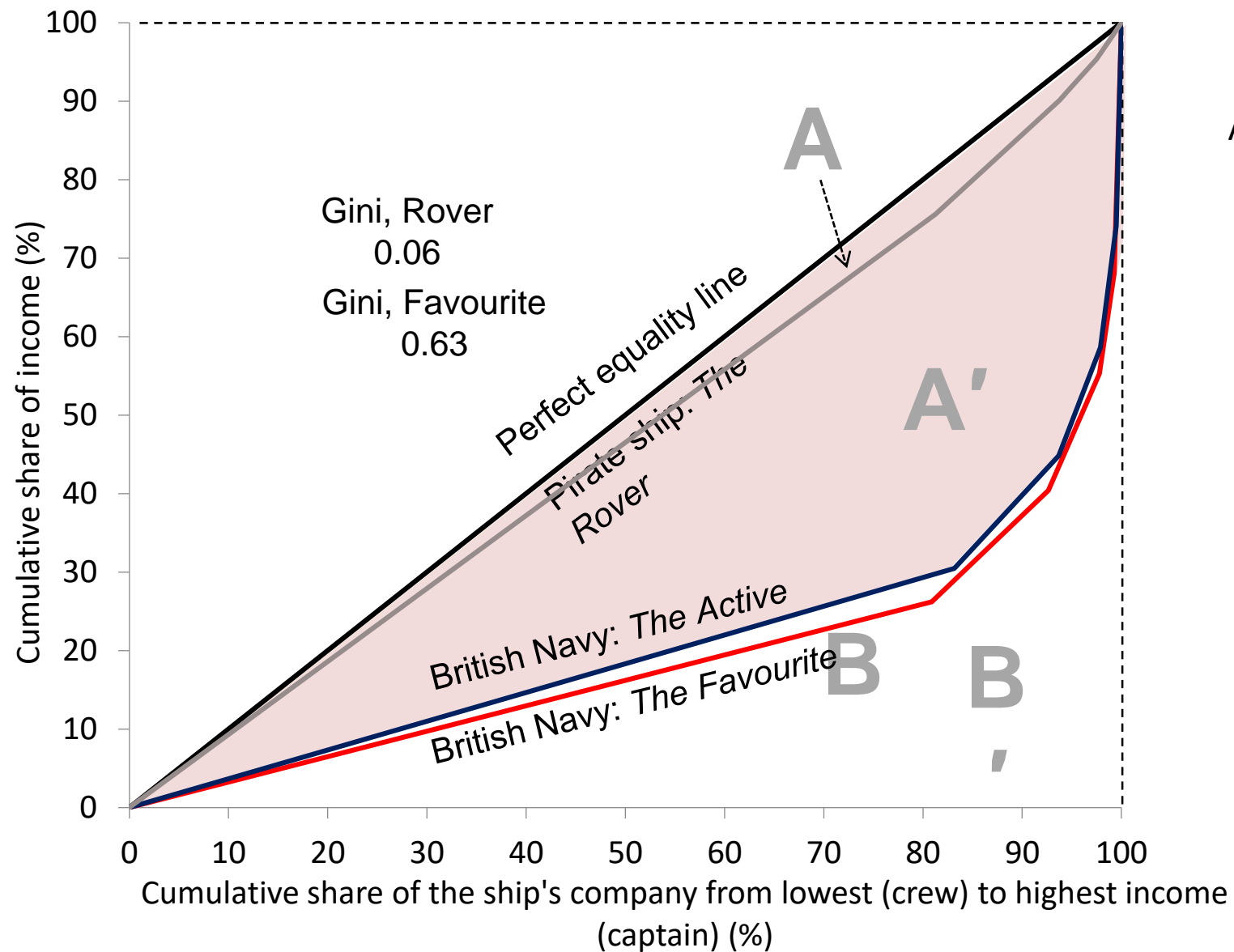
# Connecting institutions to measurement of inequality





# Constitutions and contracts

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



A Pirate Ship Lorenz Curve and Gini Coefficient



# 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

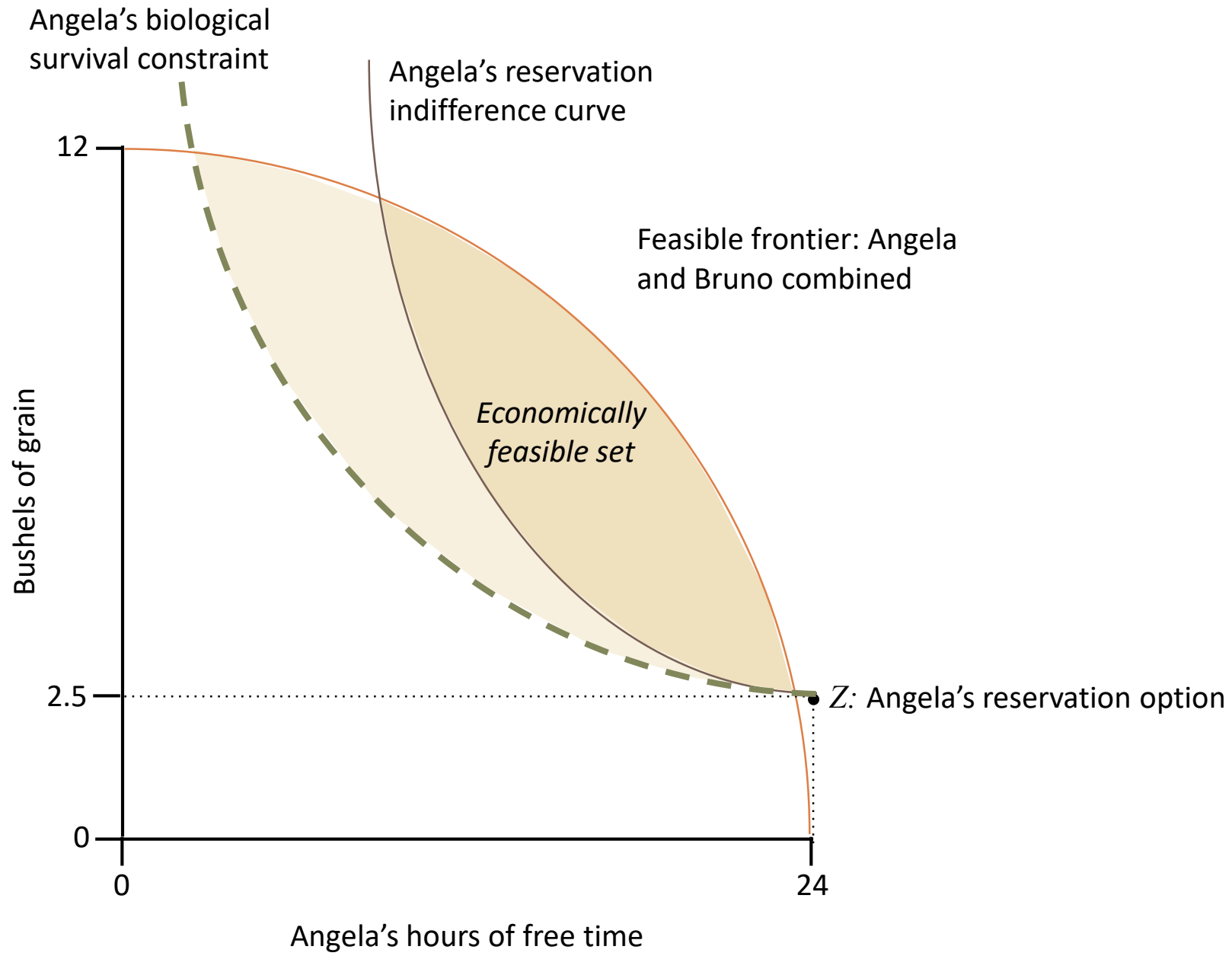


## How do institutions matter?

Scenario	The Model: Angela and Bruno's interaction	Real-world examples
A	<b>Independence:</b> 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	<b>Rule of force: Slavery.</b> 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.
C	<b>Property rights and the rule of law:</b> 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.
D	<b>Property rights, the rule of law, and the right to vote:</b> 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 <sup>th</sup> century and today. Operation Barga in Bengal changed the rules and was the result of political pressure in a democracy.

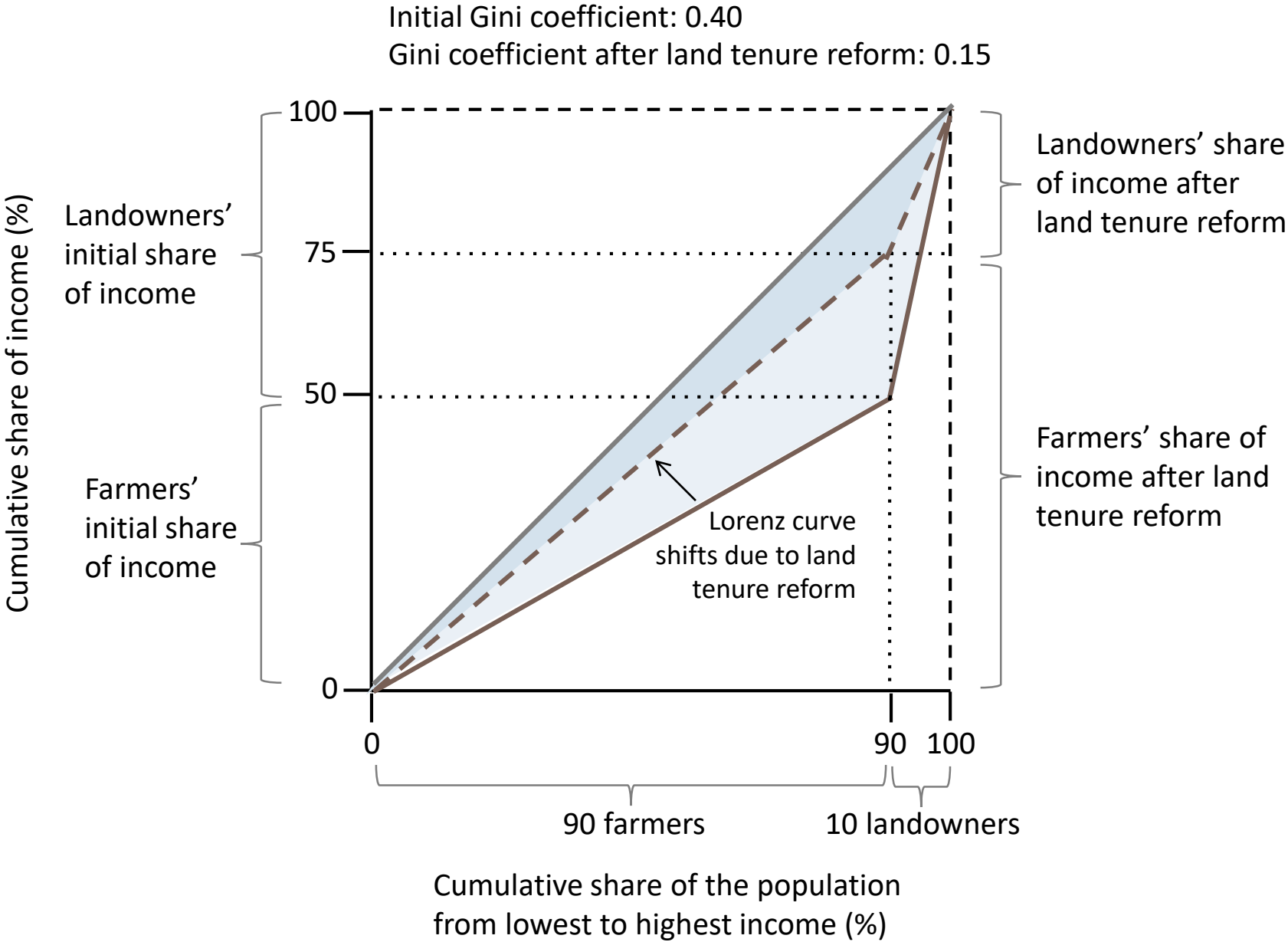


Figure 5.6. Economically feasible allocations **when exchange is voluntary.**



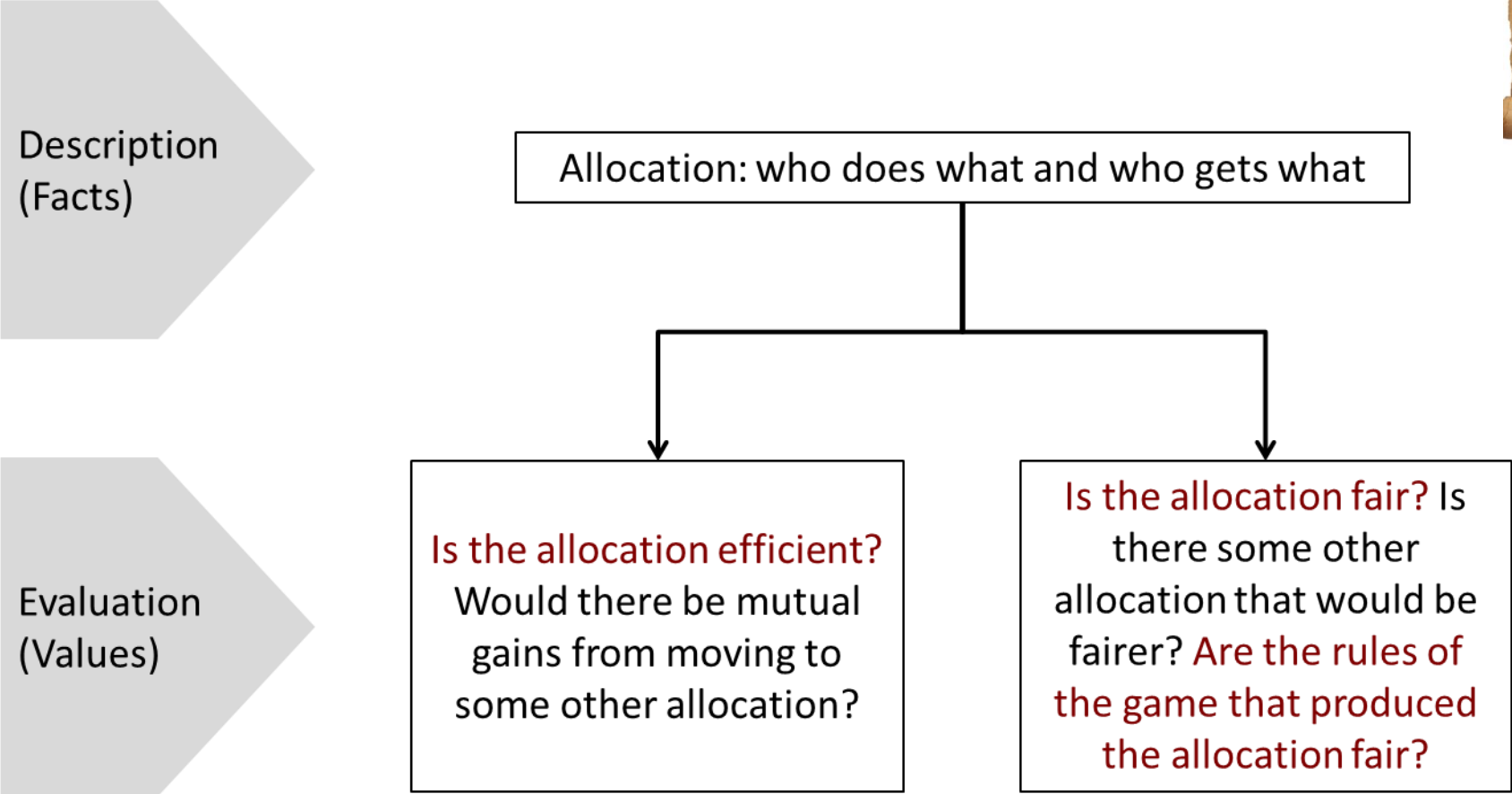
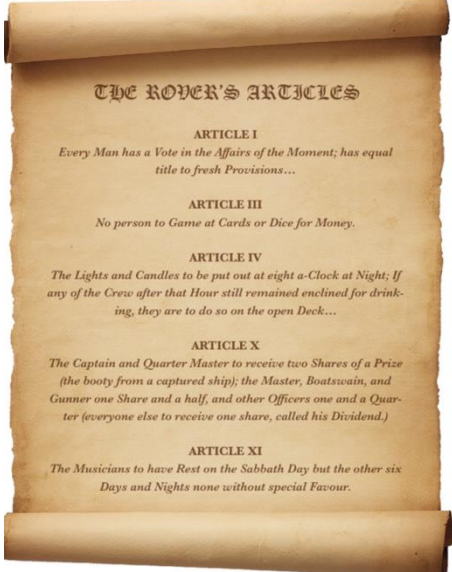


Bargaining in practice: A **land tenure reform in West Bengal** reduced the Gini coefficient





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





## A Rawlsian question (used throughout)

### EXERCISE 1.11 WHERE AND WHEN WOULD YOU CHOOSE TO HAVE BEEN BORN?

Suppose you can choose to be born in any time period in any of the countries in [Figure 1.1a](#), [1.10](#) or [1.11](#), but you know that you would be among the poorest 10% in the population.

1. In which country would you choose to be born?
2. Now suppose, instead, you know you would initially be among the poorest 10% in the population, but you would have a fifty-fifty chance of moving to the top 10% of the population if you work hard. In which country would you now choose to be born?
3. Now suppose that you can only decide on the country and time period of your birth. You cannot be sure if you would be born in the city or the countryside, would be male or female, rich or poor. In which time and country would you choose to be born?
4. For the scenario in (3), in which time and country you would least want to be born?

Use what you have learned from this unit to explain your choices.



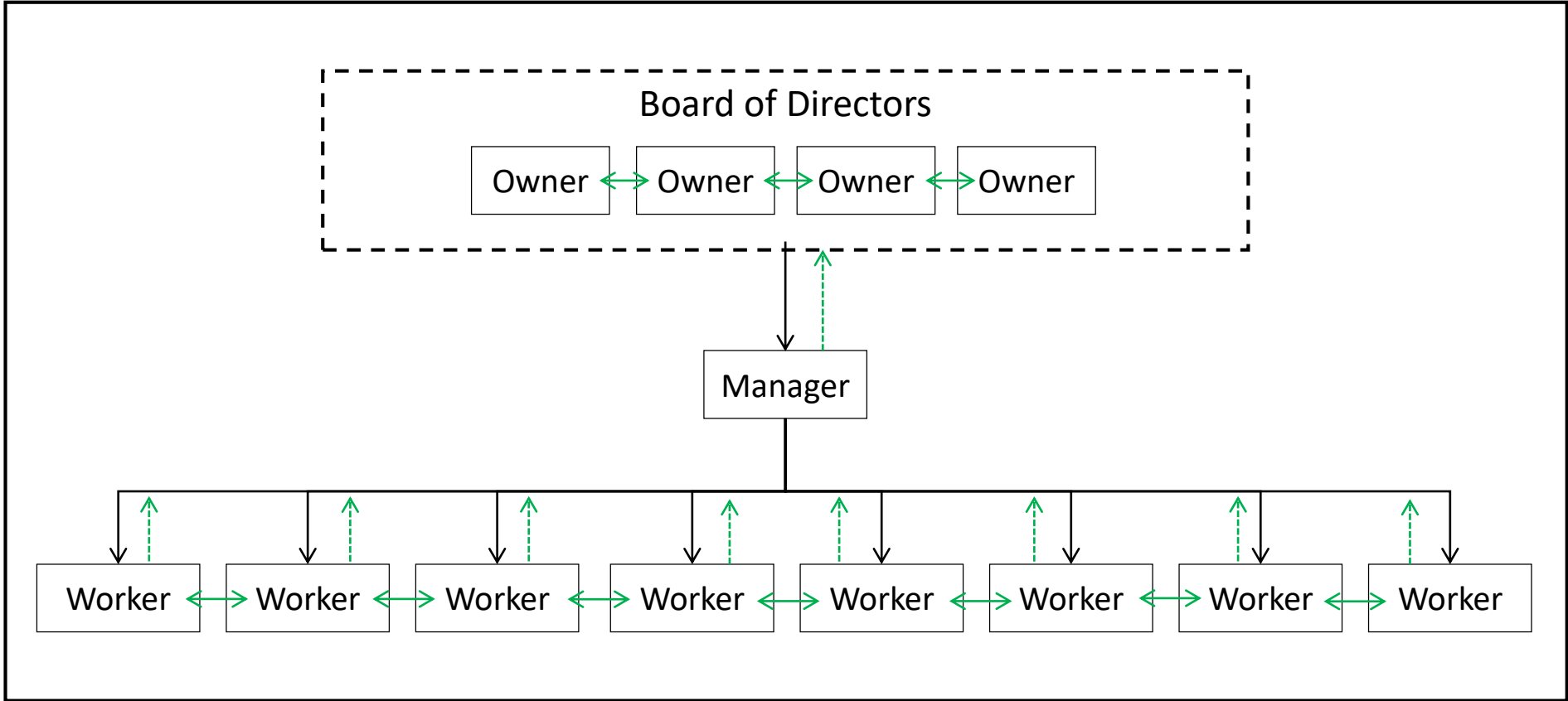
# We then apply this framework to the modern firm

---

- 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

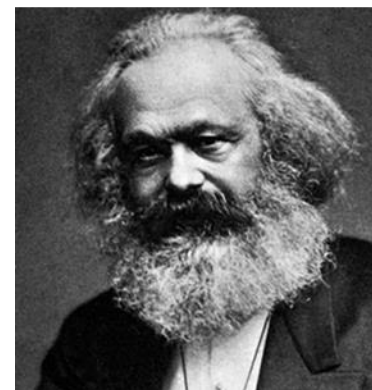
### *Coase and Marx on the firm and its employees*

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’.



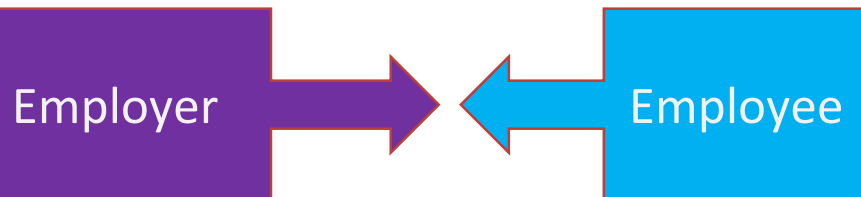


# Actors & their interactions – a foundation for understanding the aggregate economy

## 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.

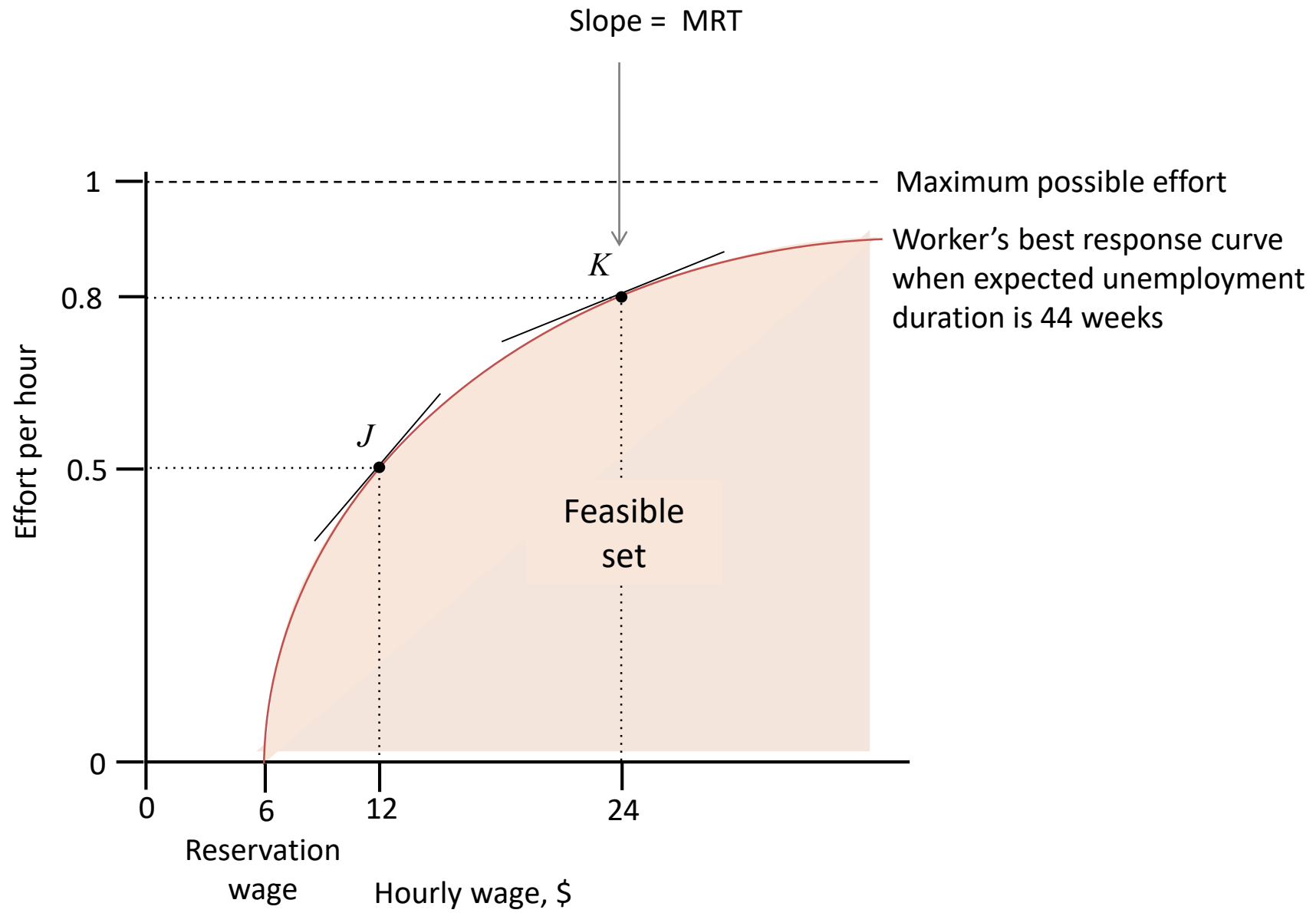




Figure 6.5. The employer's indifference curves: isocost lines for effort.

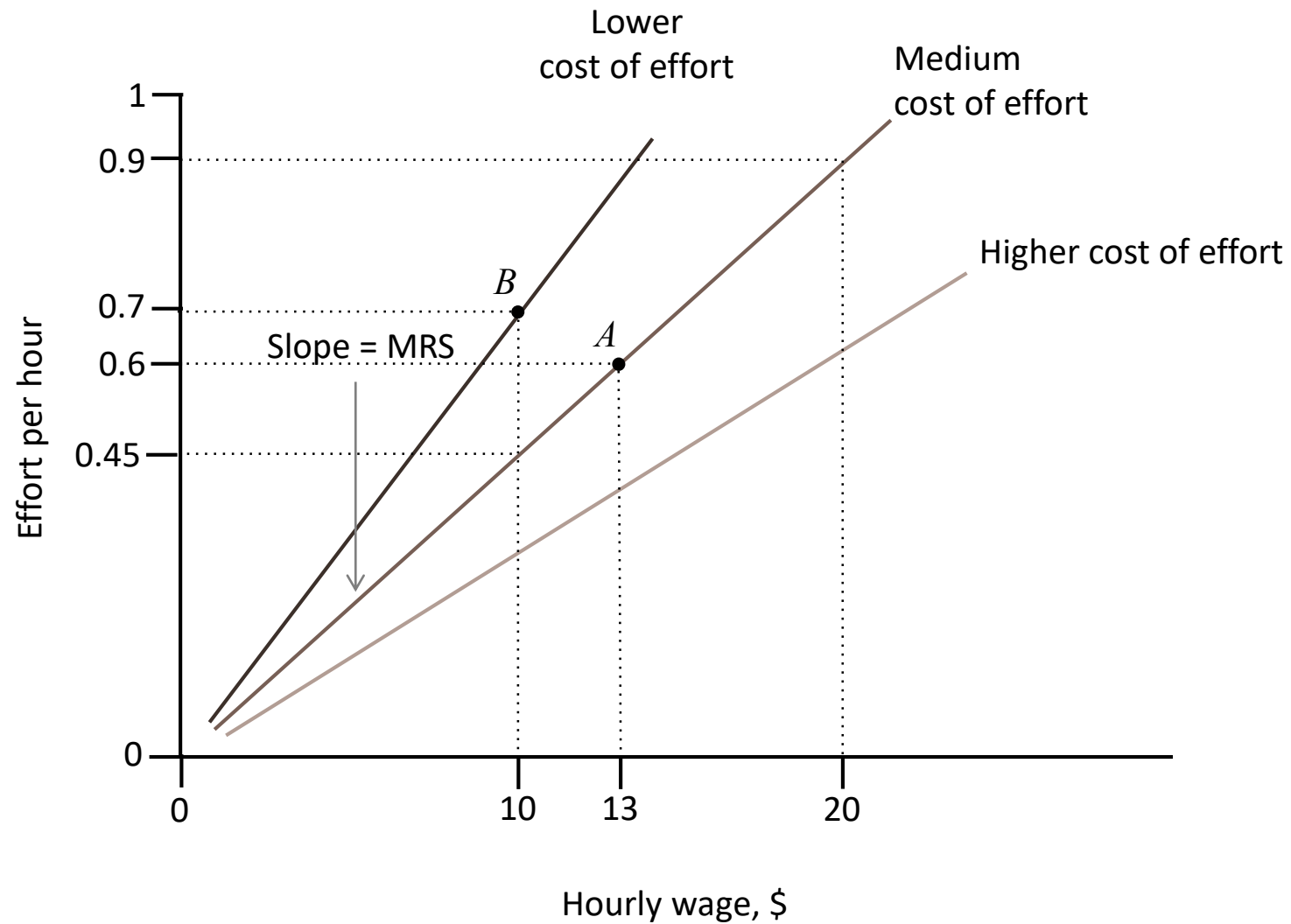




Figure 6.6. The employer **sets the wage** to minimise the cost of effort.

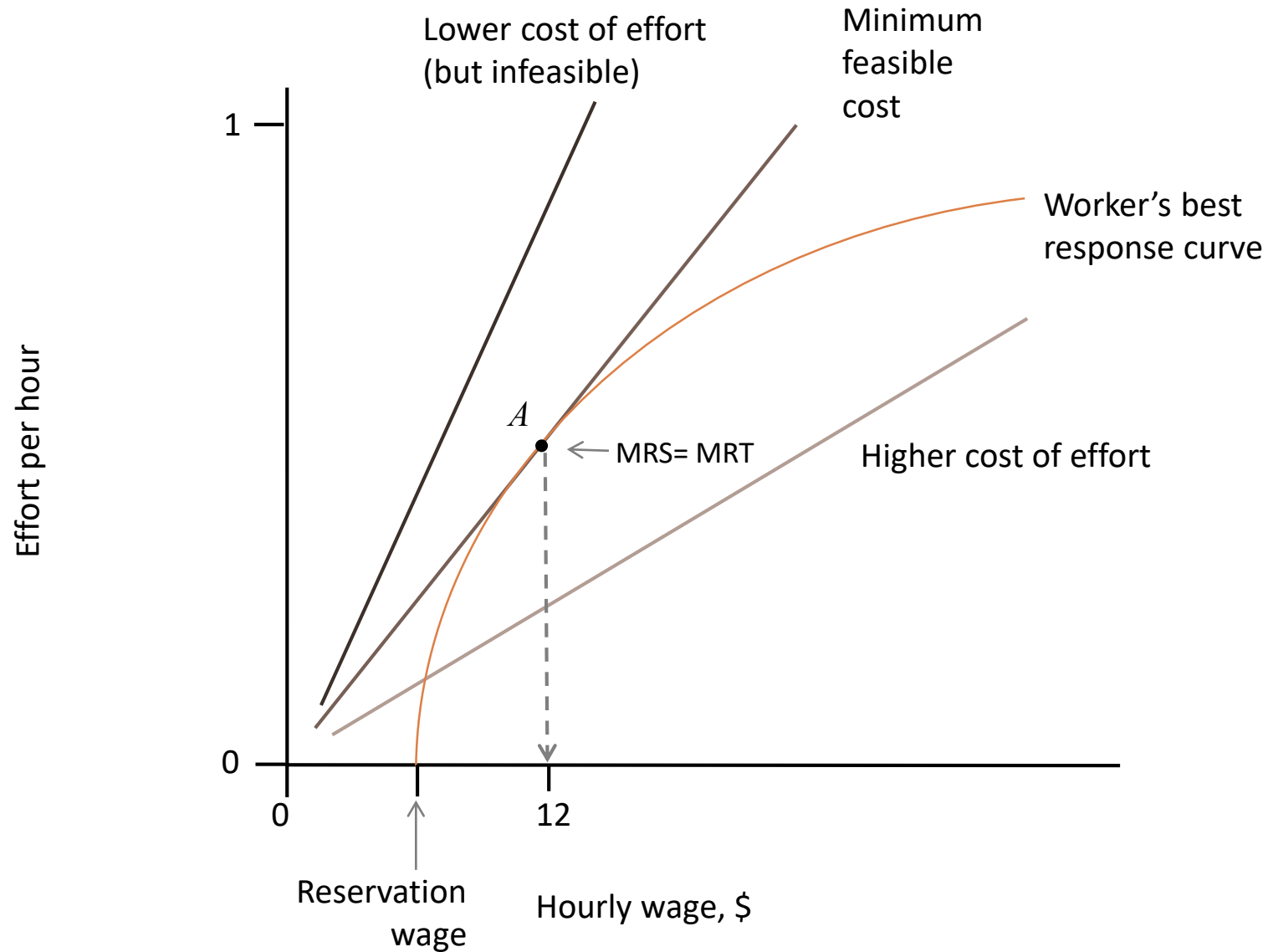
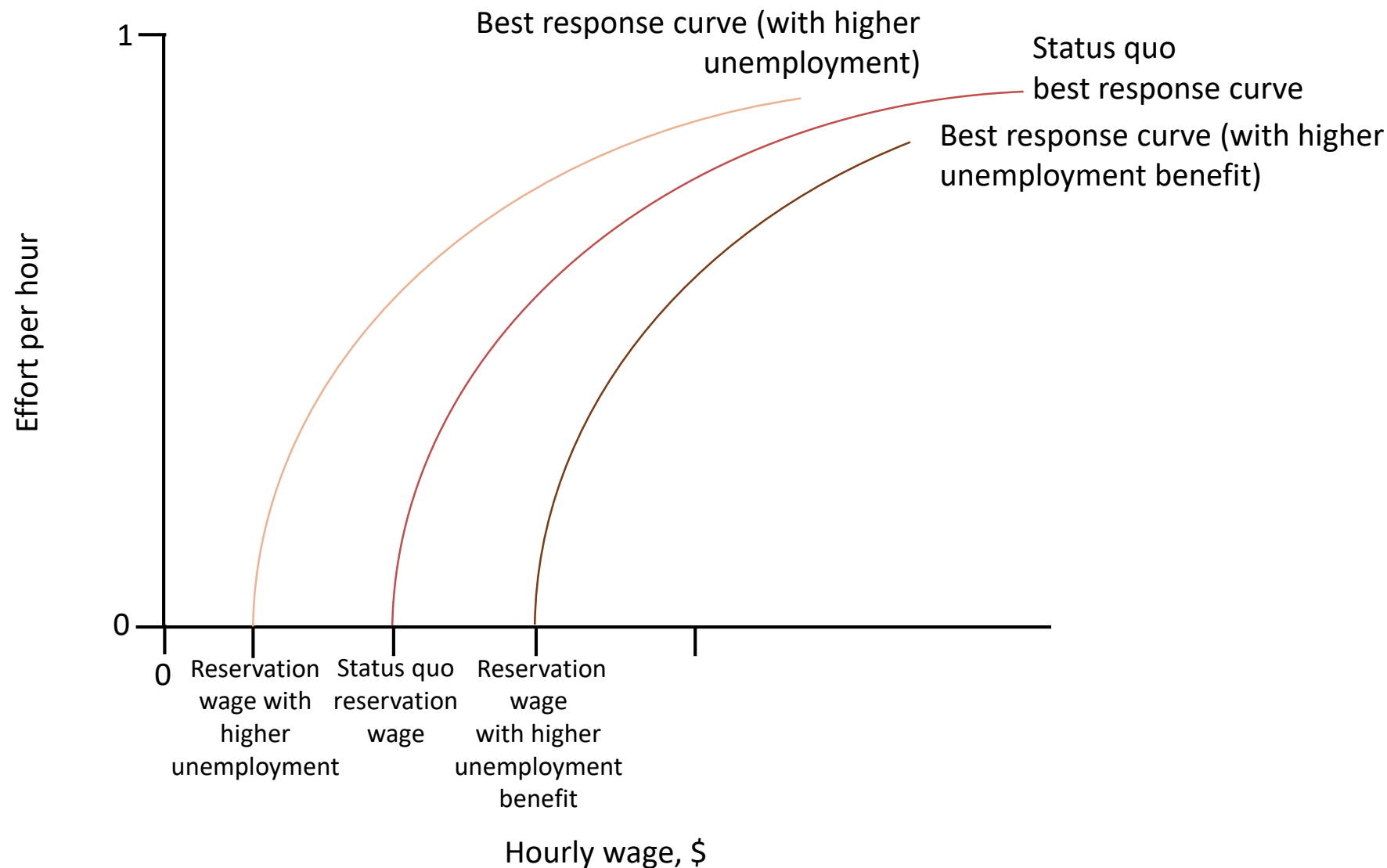




Figure 6.7. The best response curve depends on the level of unemployment and the unemployment benefit.





# 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 interviewed workers during the global financial crisis, to see how the management of the firm changed during 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 allowed it to track the productivity of workers and worker effort.

It also allowed Lazear and his colleagues to use the firm's data 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.



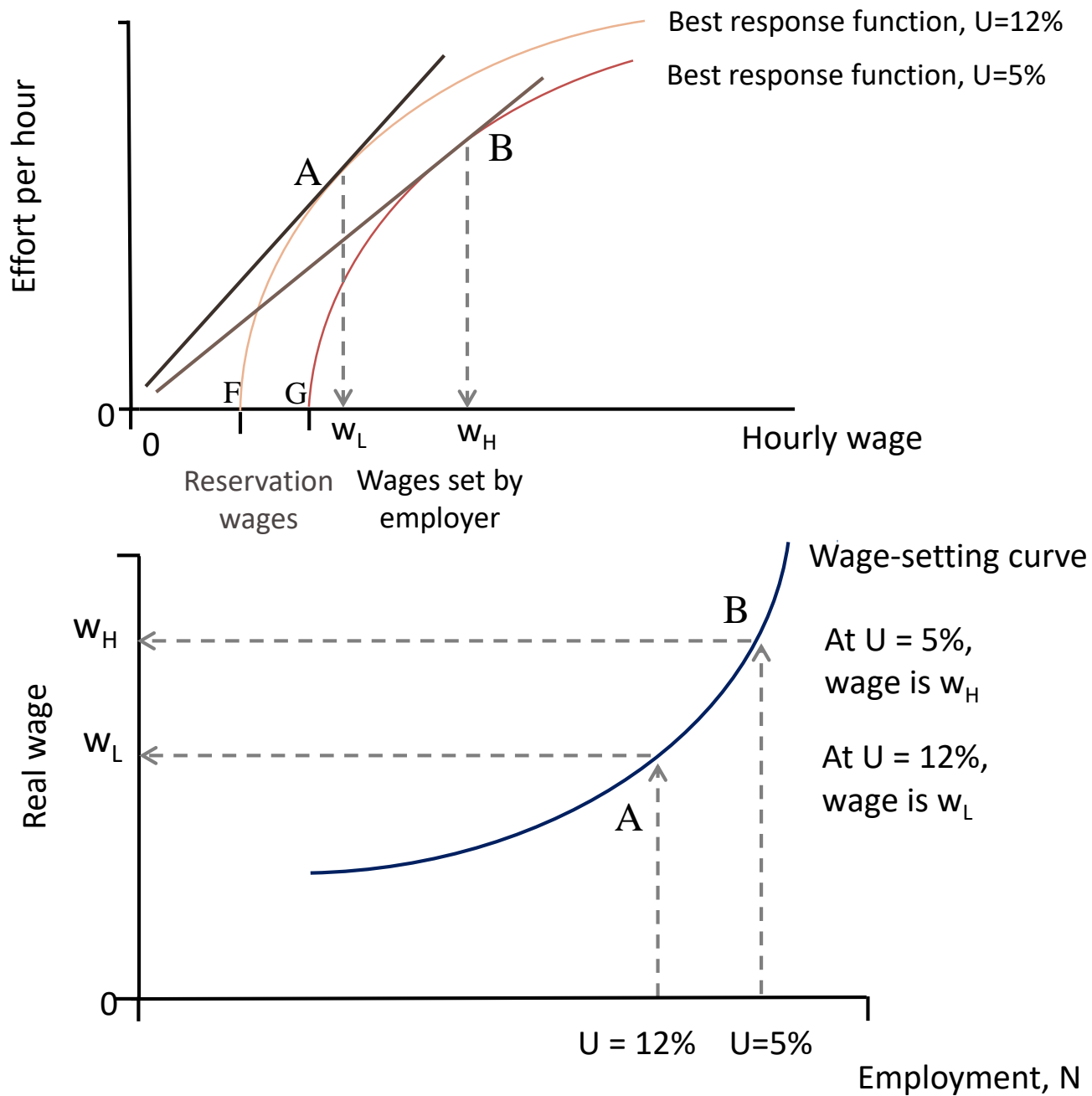
# From conflicts within the firm to economy-wide unemployment and inequality

---

- 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  $\leftrightarrow$  Macro  $\rightarrow$  Data

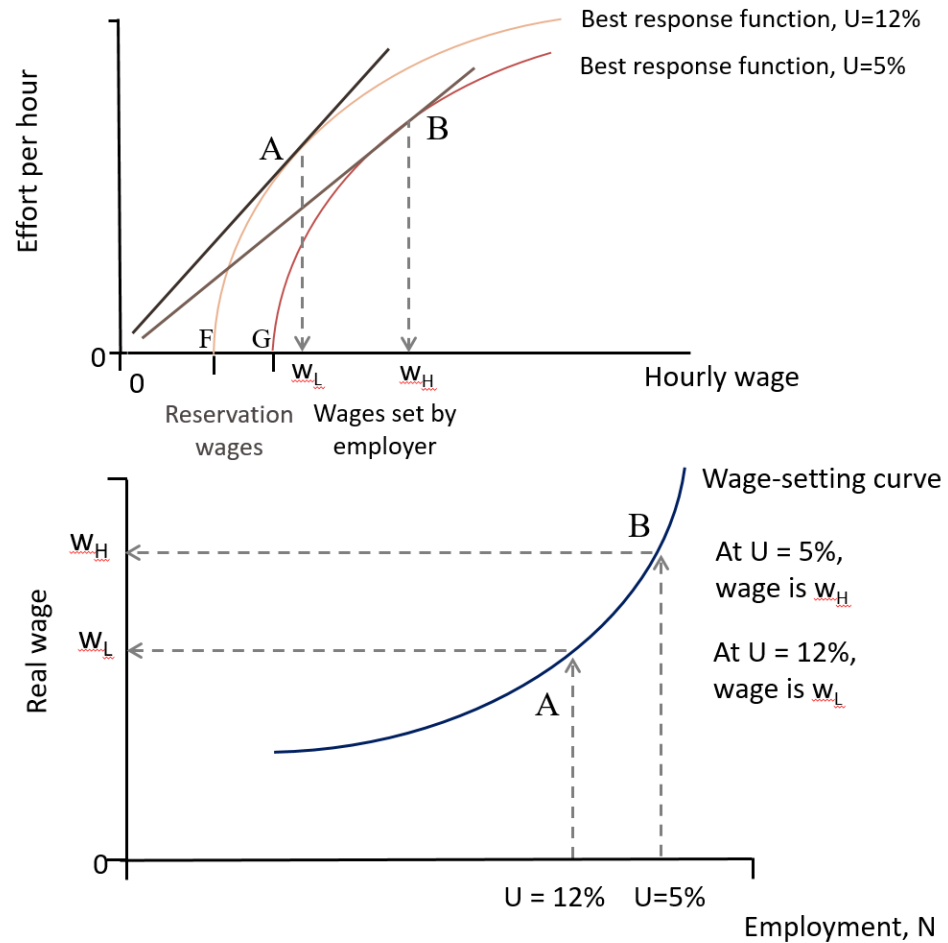


Figure 9.6. A wage-setting curve estimated for the United States economy (1979-2013).

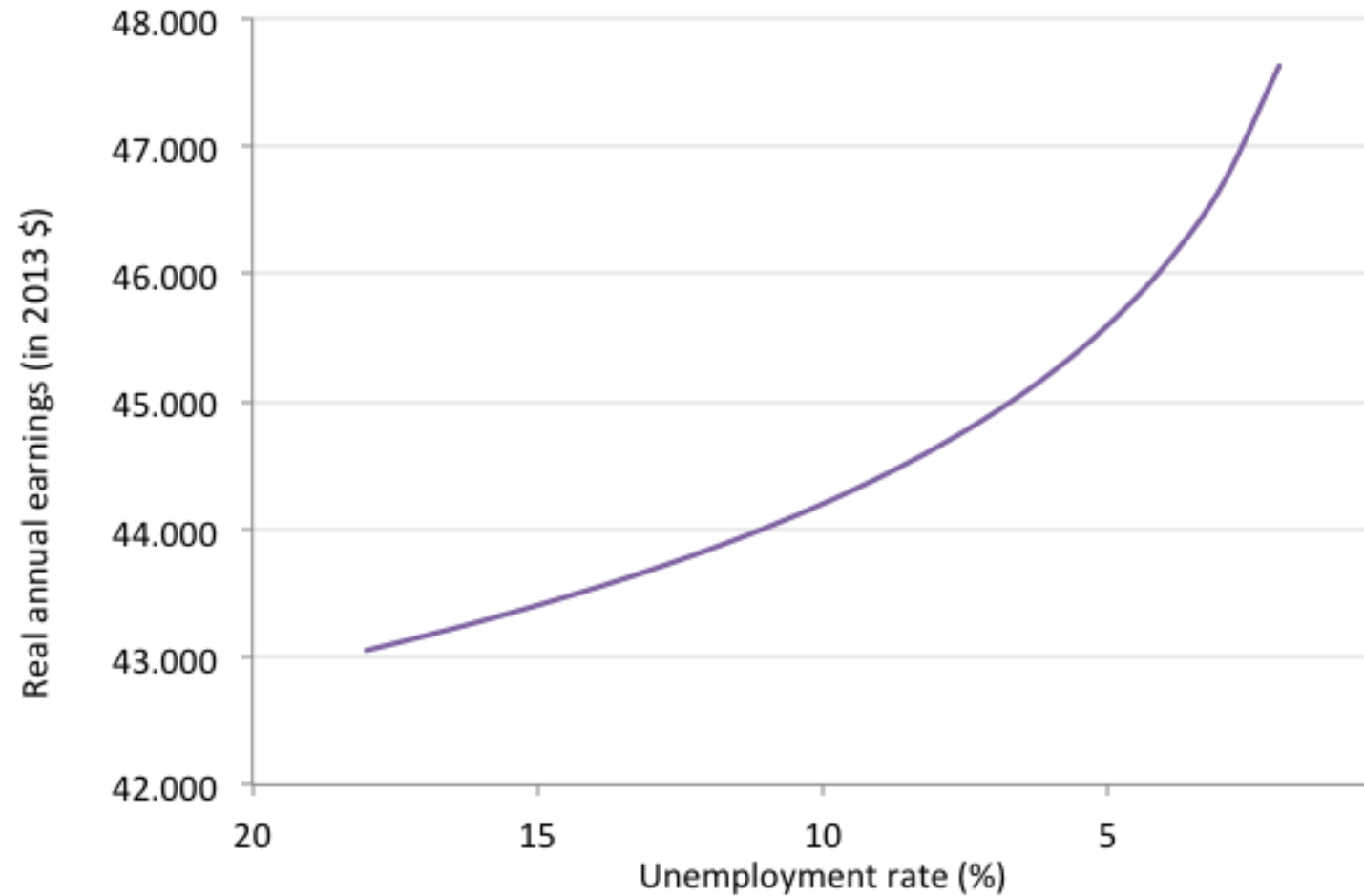
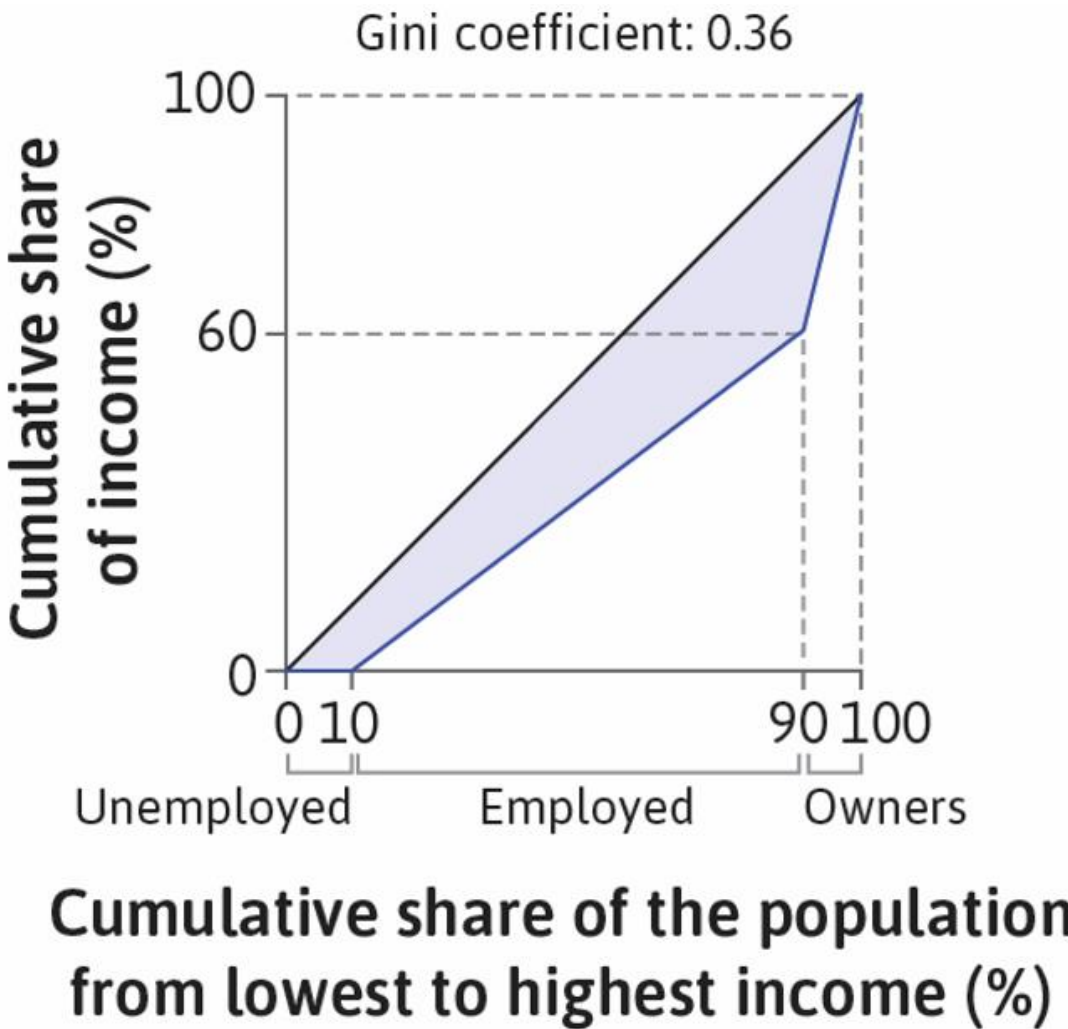
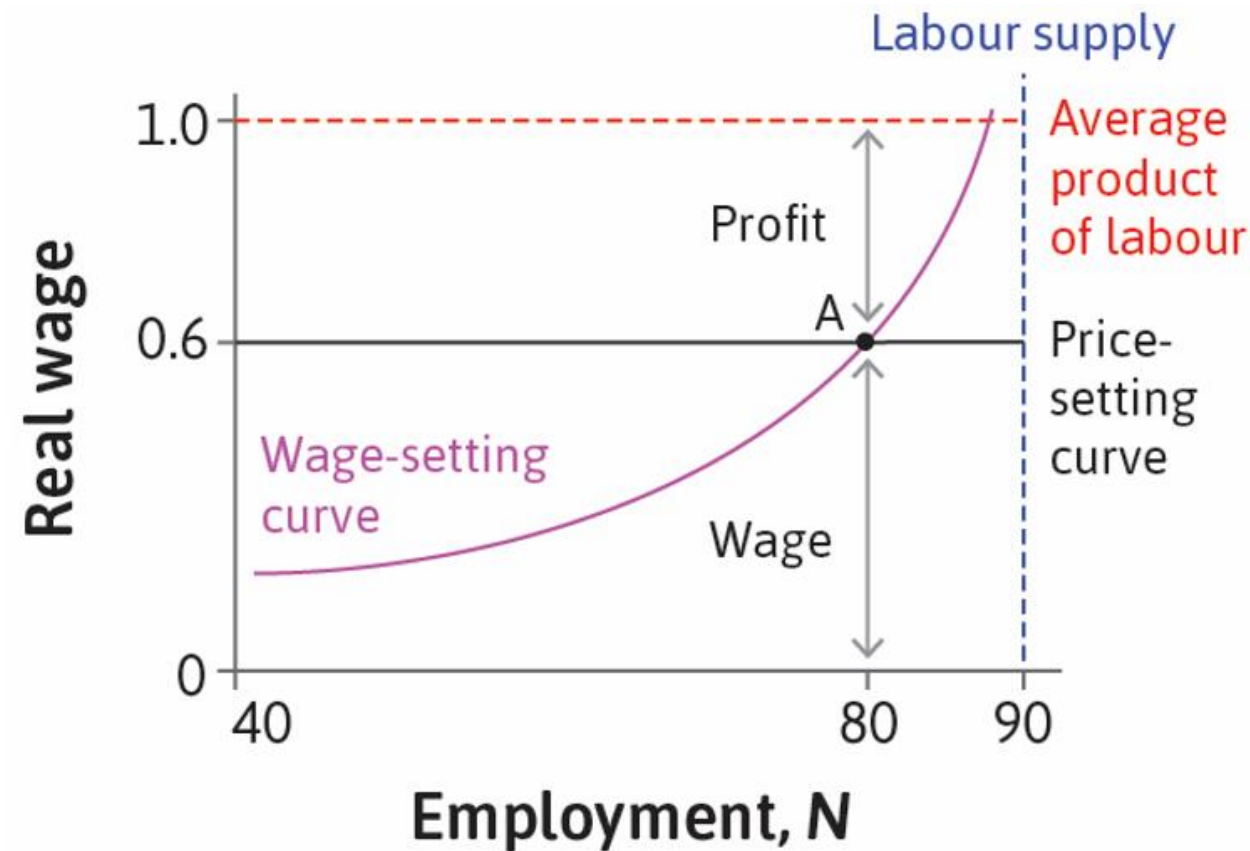




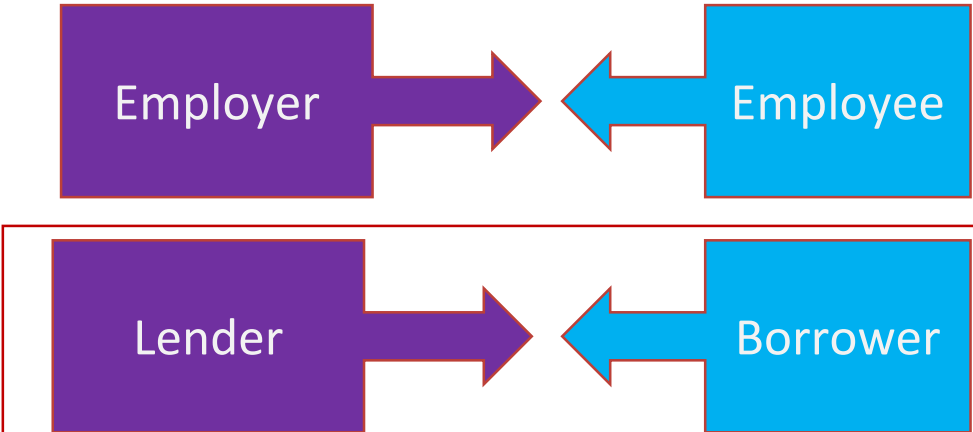
Figure 9.16. The distribution of income at labour market equilibrium. (right panel)

Micro  $\leftrightarrow$  Macro  $\rightarrow$  Inequality





# Aggregate demand and fluctuations – a second principal-agent problem



	Actors	Conflict of interest over	Enforceable contract covers	Left out of contract (or unenforceable)	Result
<b>Labour market</b> (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
<b>Credit market</b> (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

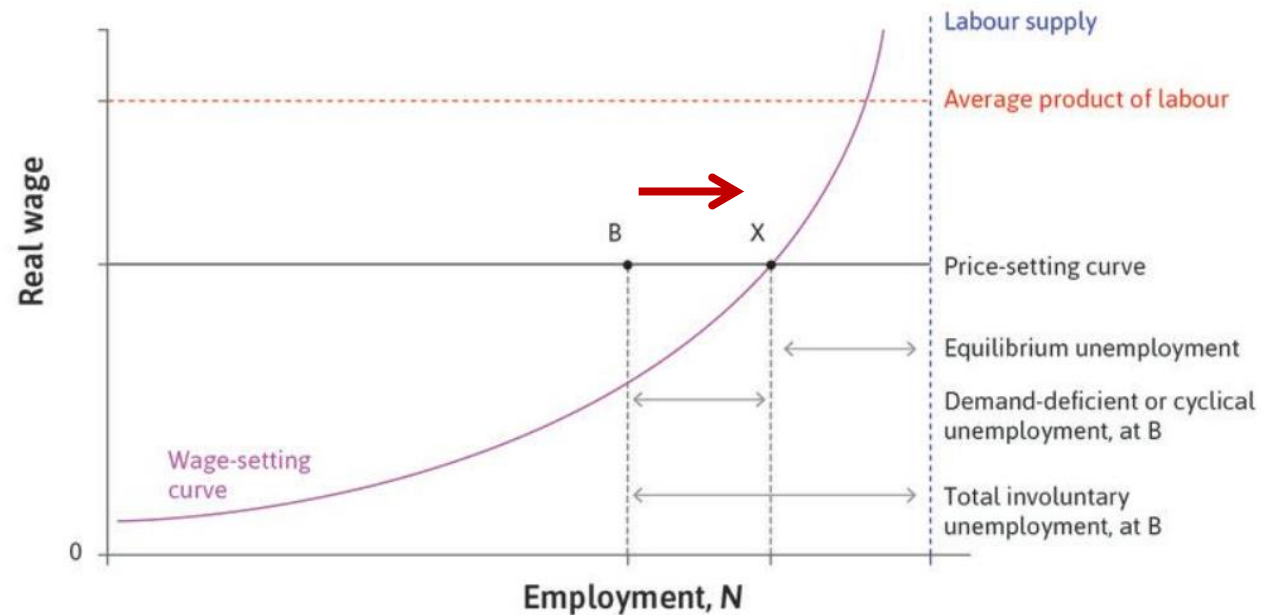


# Cyclical unemployment and aggregate demand – using the model of the price-setting firm

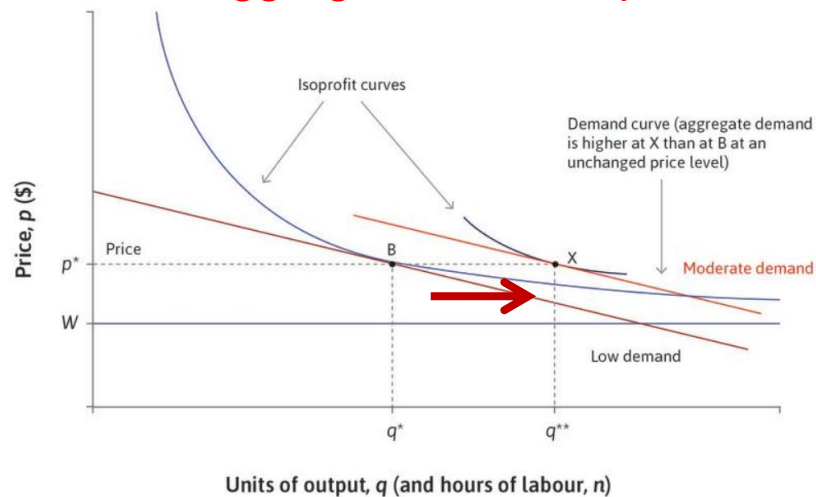
## 9.7 How changes in demand for goods and services affect unemployment

Politics and policy

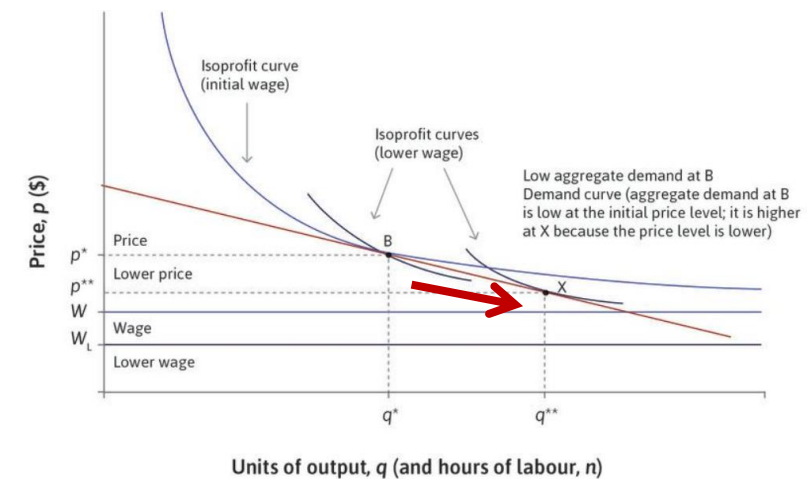
The problem: demand-deficient unemployment at B



Solution #1. Use aggregate demand policies

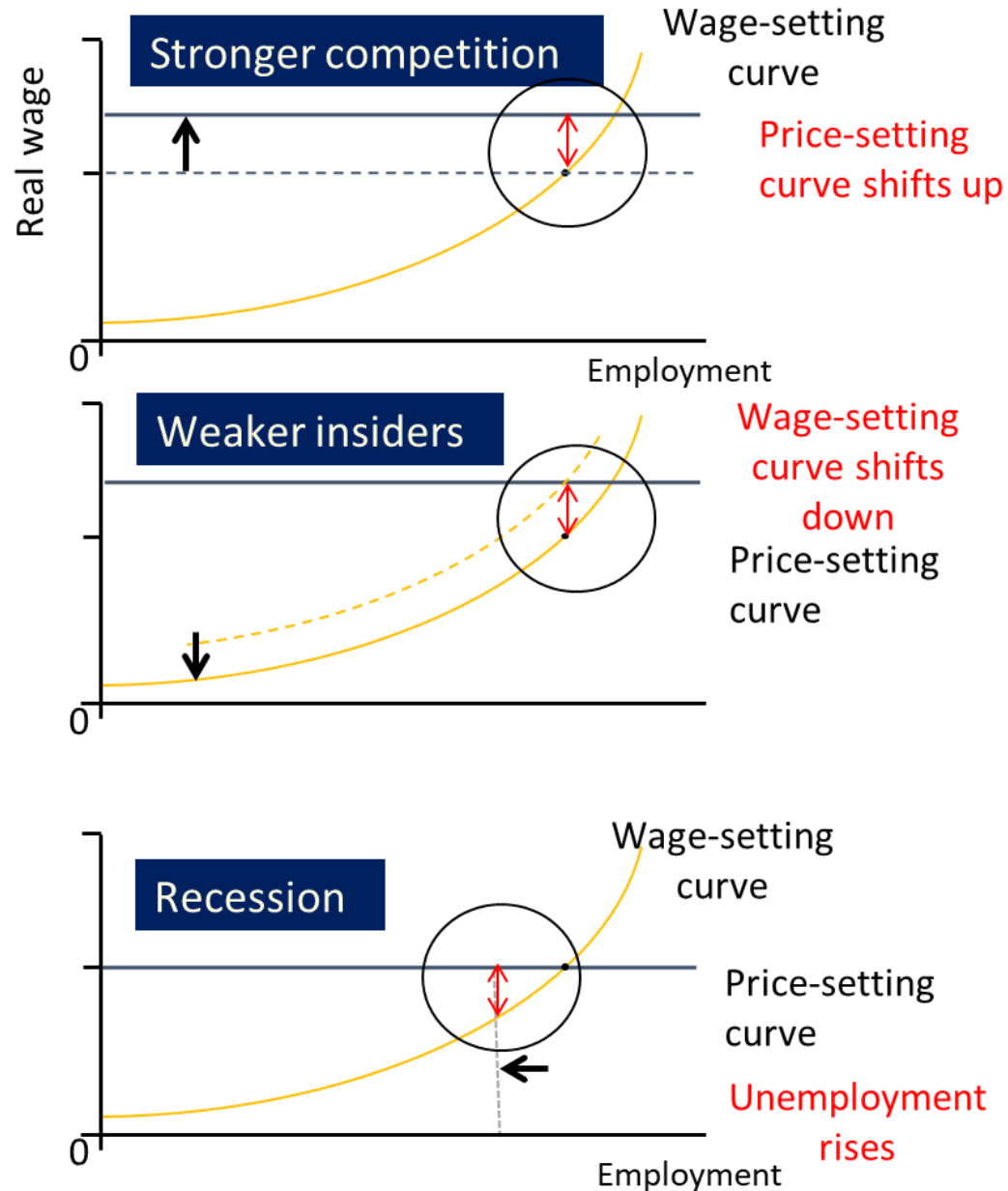


Solution #2. Rely on downward price and wage flexibility





# Why is inflation falling?



1. Owners' power falls relative to consumers

Always ask: what has happened to the bargaining gap?

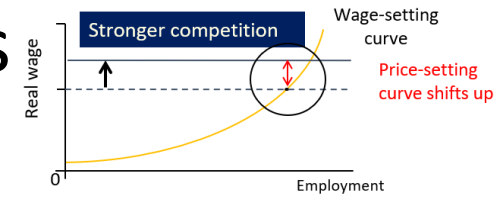
2. Employees' power falls relative to owners

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

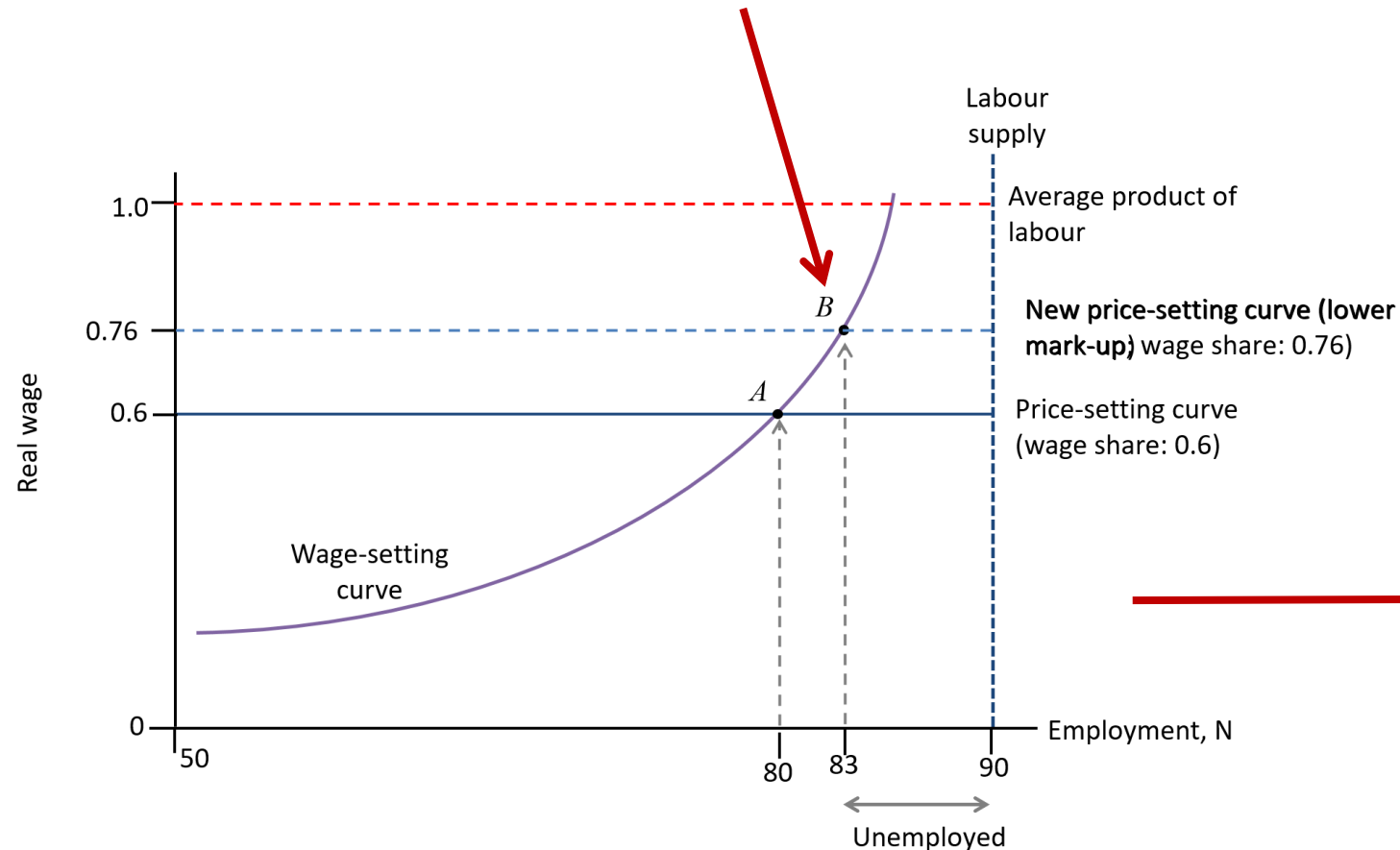


# Inequality in the aggregate economy – using Lorenz curves

## The effect of an increase in the degree of competition

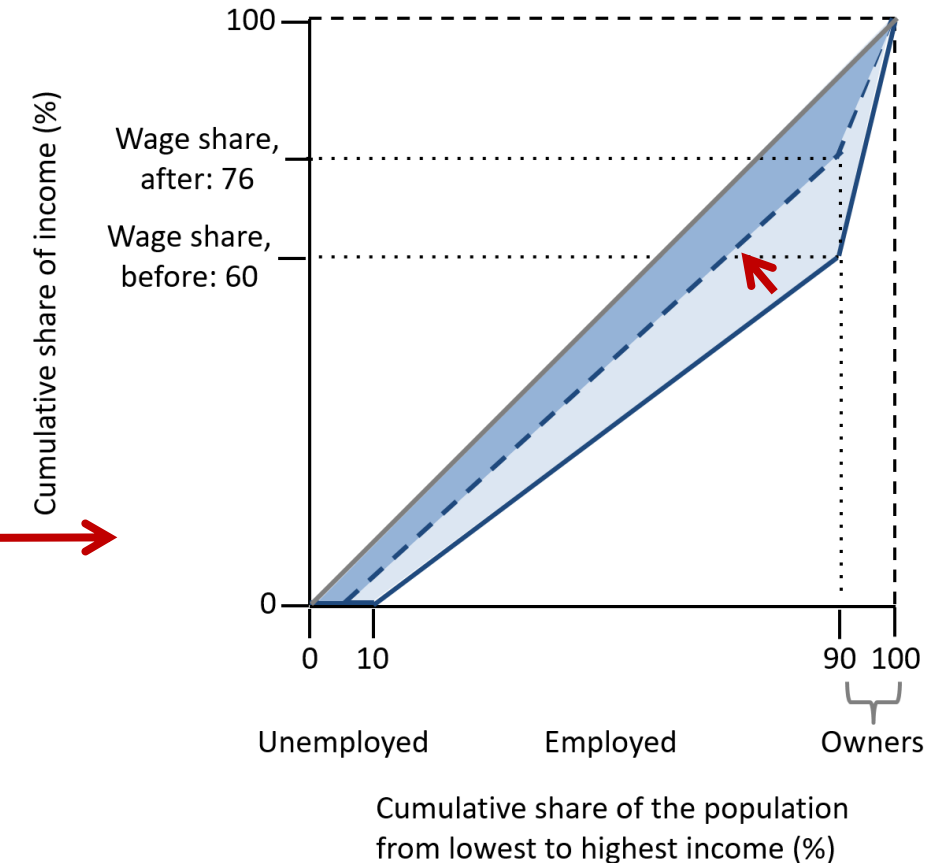


Lower unemployment and higher real wage in equilibrium



A lower Gini coefficient

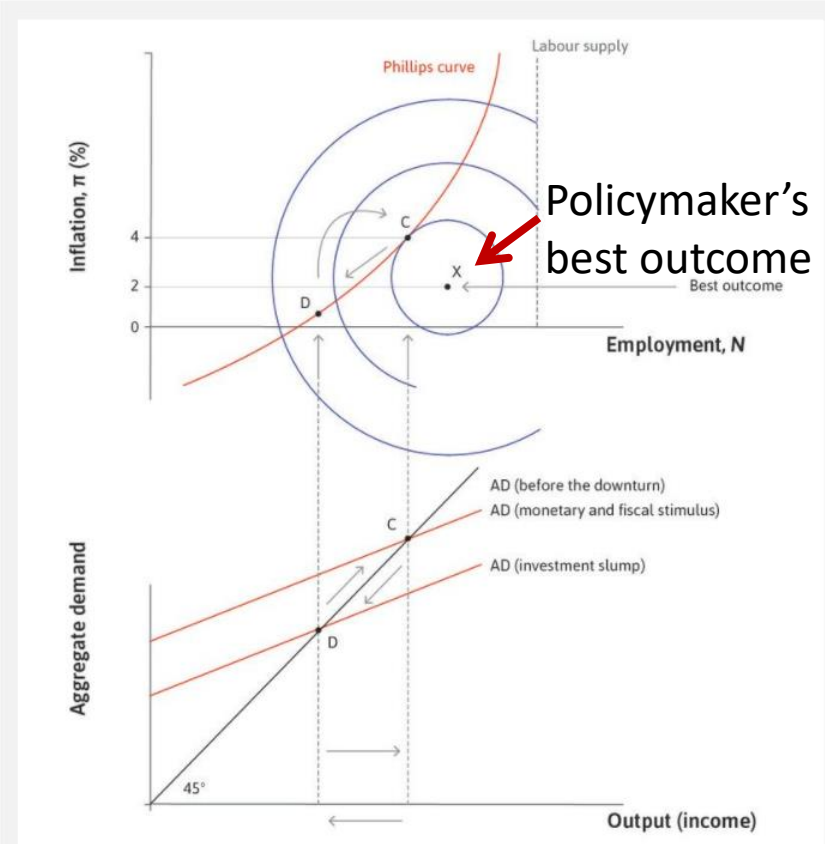
Gini coefficient: 0.36 before;  
Gini coefficient 0.19 after





# Government and central bank as actors – using constrained optimization

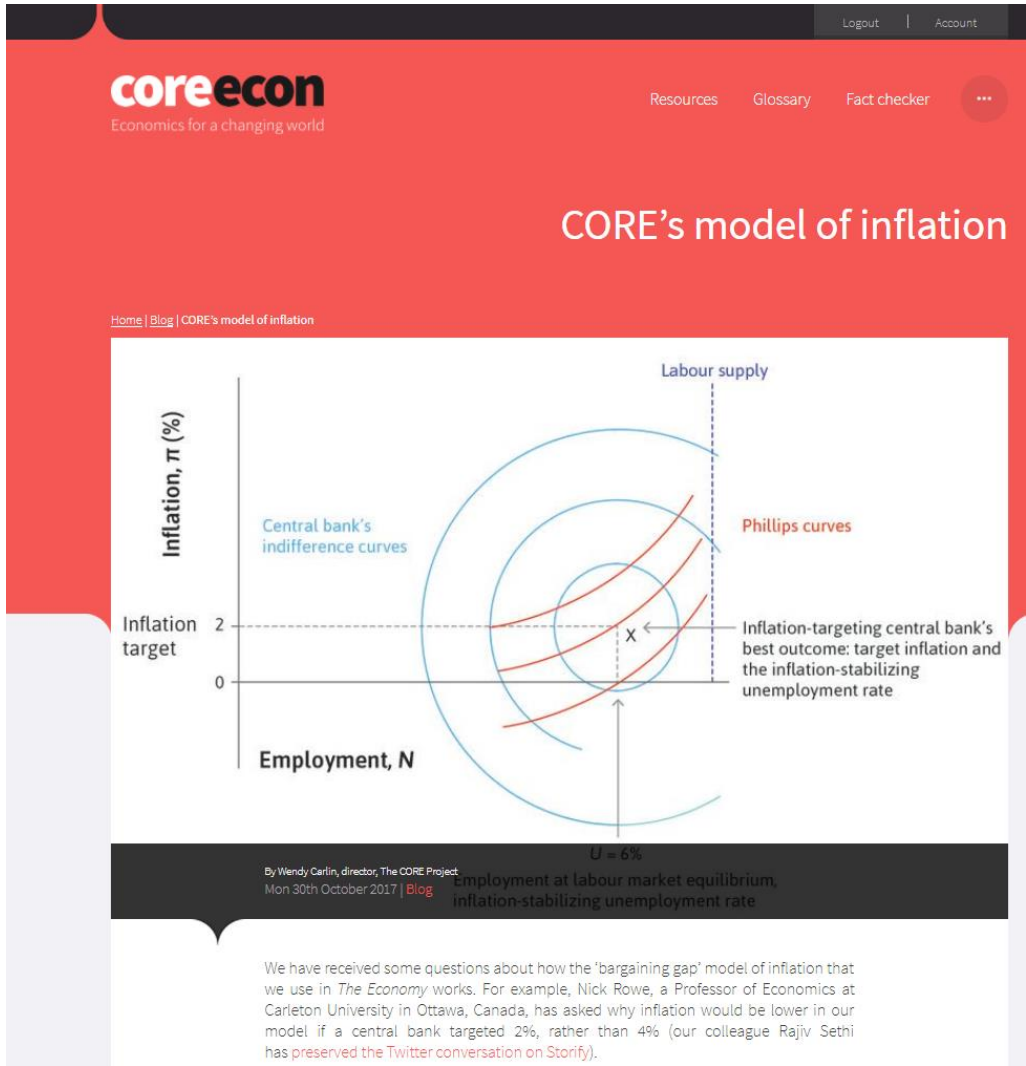
Read more here  
on the CORE blog



### The effect of intervention

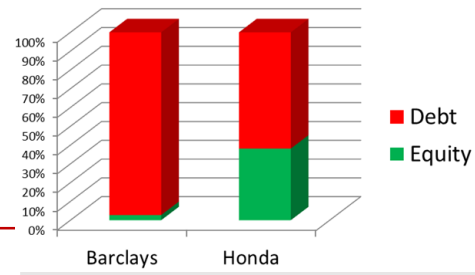
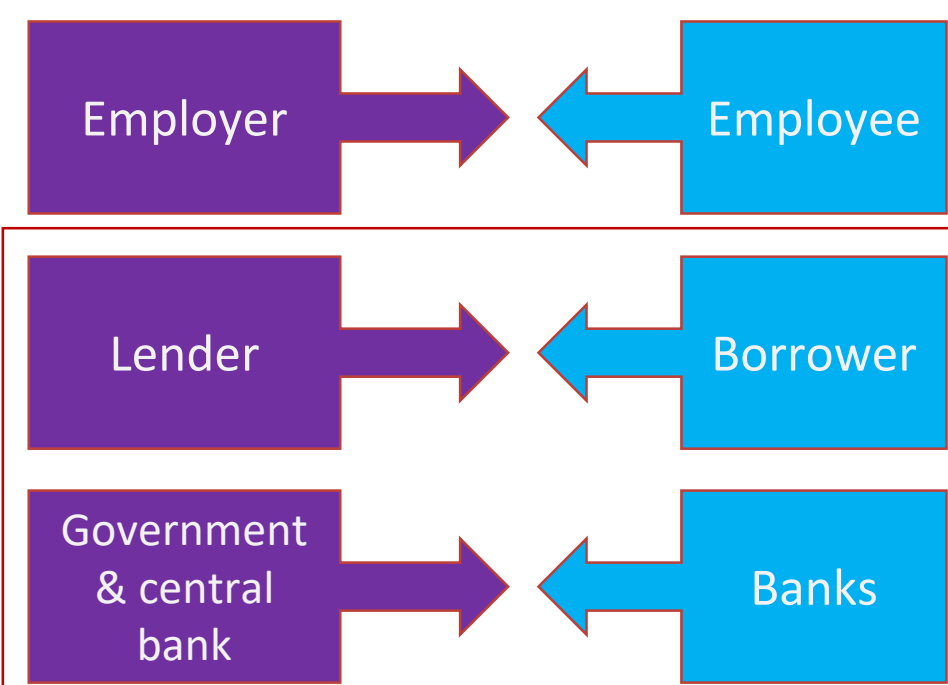
The increase in output from higher aggregate spending reduces unemployment and raises inflation. The economy moves back along the Phillips curve to point C.

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

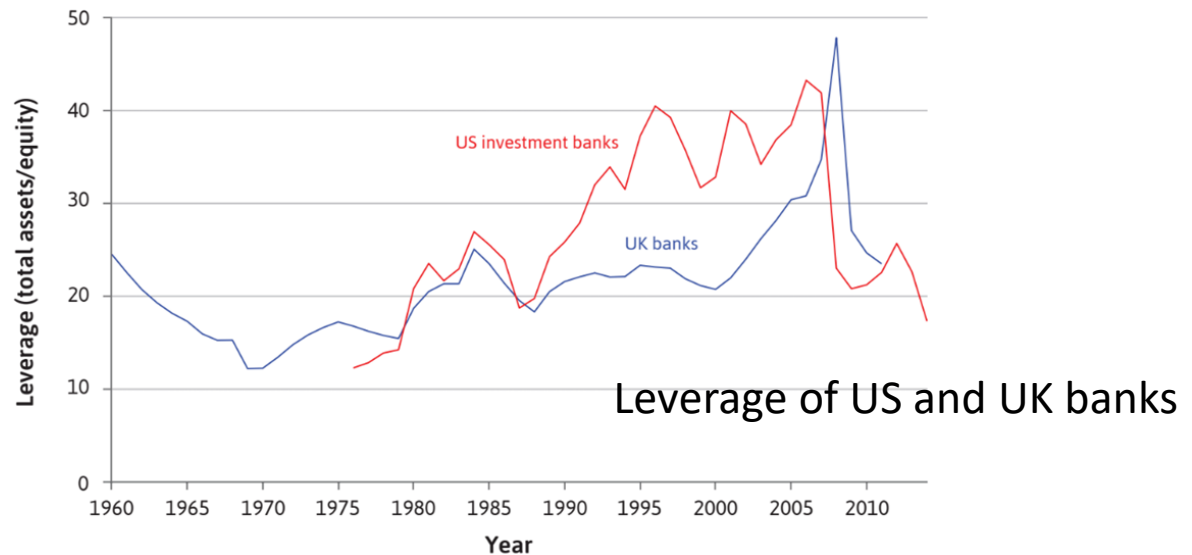
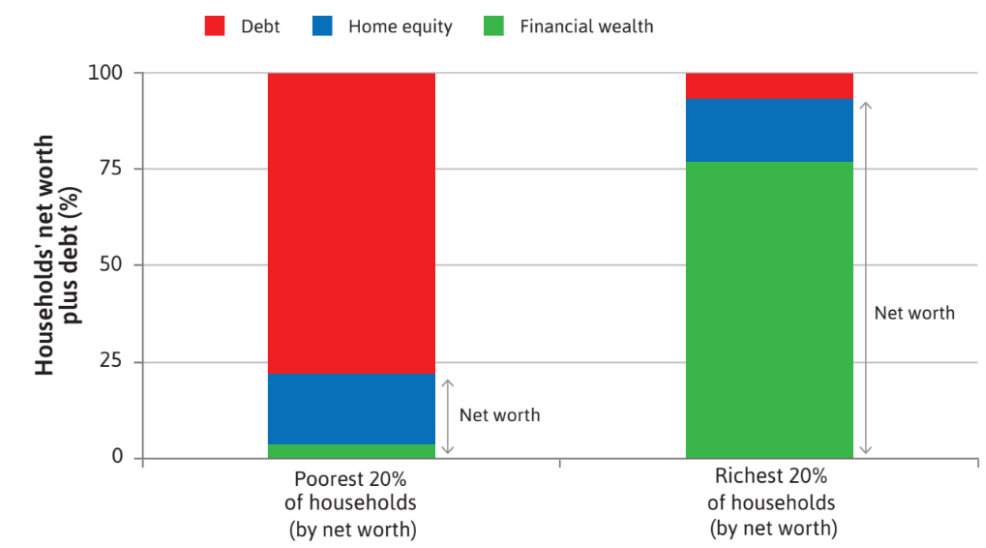




# And a third principal-agent problem to analyze bank risk-taking



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***

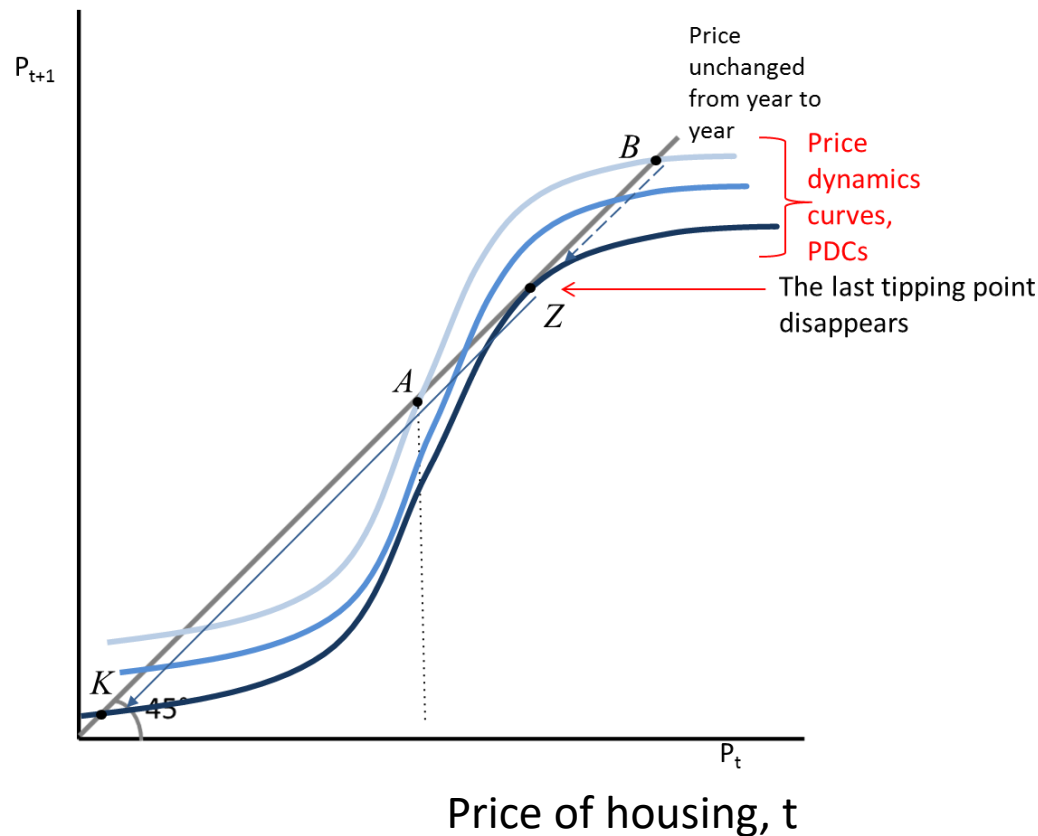
- Schumpeterian rents, disequilibrium
- Social interactions / other-regarding preferences
- Rents, bargaining power, institutions
- Incomplete contracts in labour & credit markets
- **Prices as information & dynamics of price-setting**



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

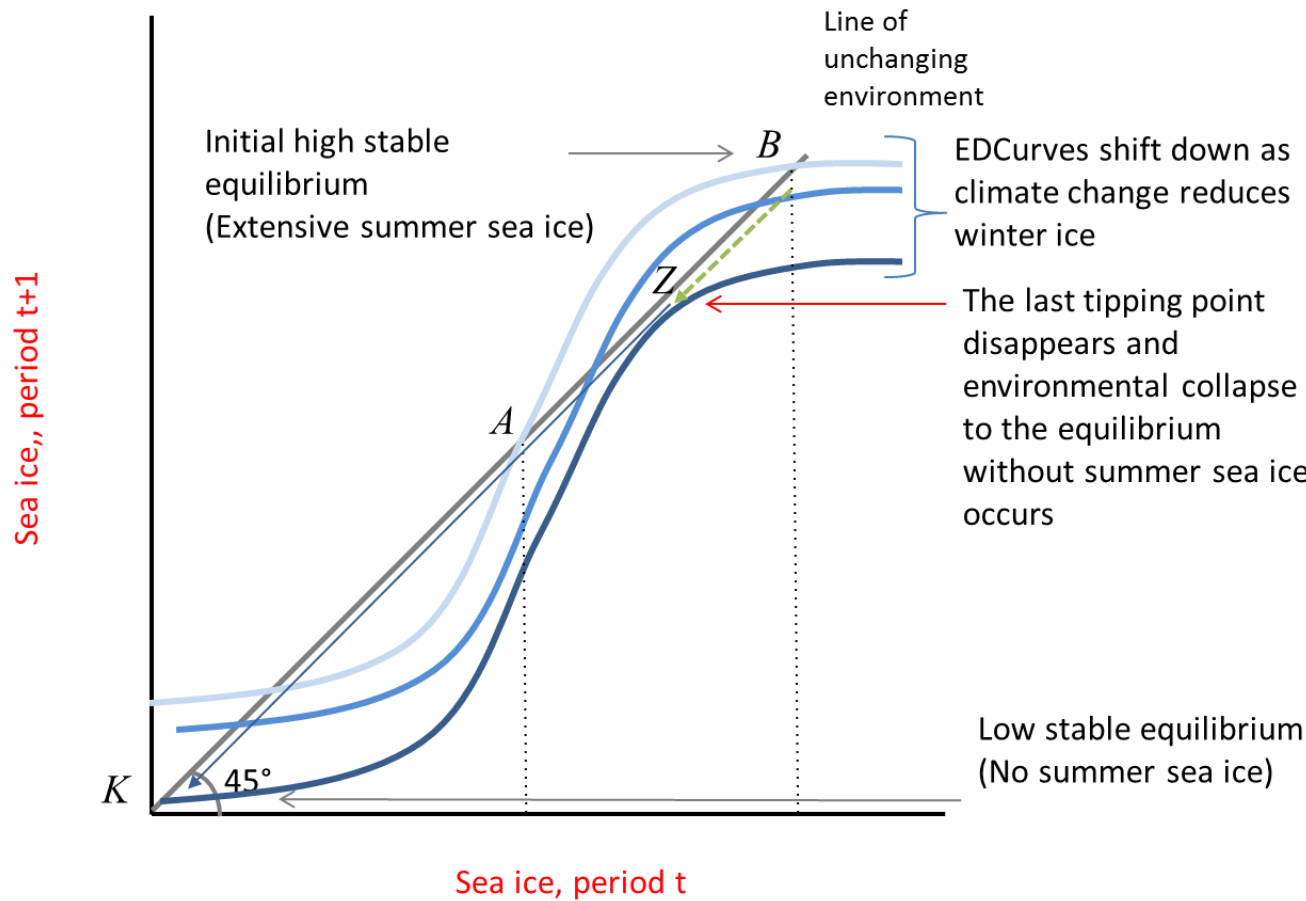
## A bubble in the housing market

A tipping point in the housing market.



## An environmental tipping point

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





# 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	Econ 101	CORE, and contemporary economics
• What the economy is	Static, self-contained system	Always-changing process embedded in society & biosphere
• What people are like	<i>Homo economicus</i>	Also, have social preferences, respond to norms; are principals and agents
• How we interact in the economy	Perfectly competitive markets	Also, price-making, strategic and non-market interactions associated with static & dynamic economic rents
• The economic outcomes of these interactions	Static and 'optimal'	Include dynamic responses and pervasive external effects
• How these are to be evaluated	Unexploited mutual gains	Also, fairness
• How they may be improved by public policy	Limited to narrowly defined market failures	Of central concern





Aggregate demand

Samuelson 1948  
= Marshall + Keynes

Strategic interaction

Information is scarce and local



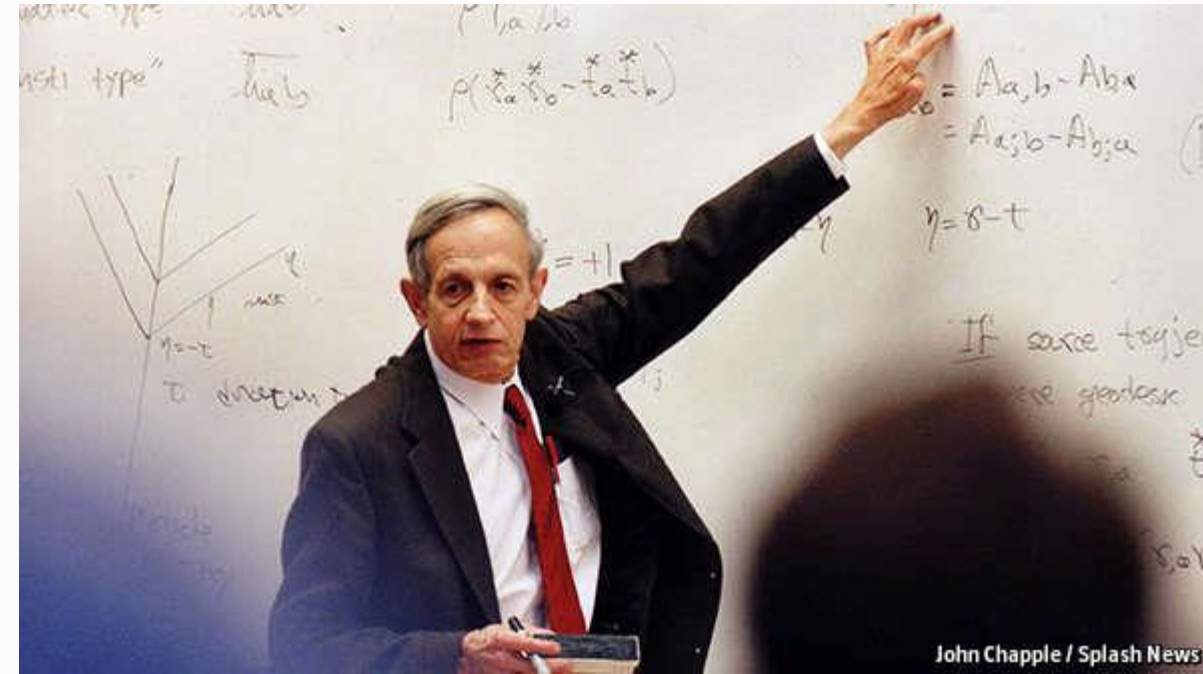
# Back to: Problems, paradigms and texts



Aggregate demand



F. A. Hayek (1889-1992) Nobel laureate, Cato Institute Honorary Distinguished Senior Fellow



Strategic interaction

Information is scarce and local



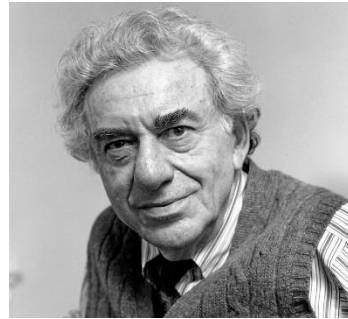
# Back to: Problems, paradigms and texts – integrating insights



The entrepreneur, creative destruction

**Joseph Schumpeter**

*The Economy* Units 2, 16, 21



Instability and risk

**Hyman Minsky**

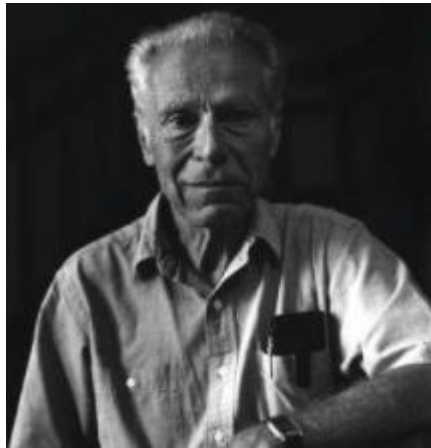
*The Economy* Units 10, 17



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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### 3 Measuring the effect of a sugar tax

Learning objectives

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### 4 Measuring wellbeing

Learning objectives

Introduction

Working in Excel

Working in R

### 5 Measuring inequality

Learning objectives

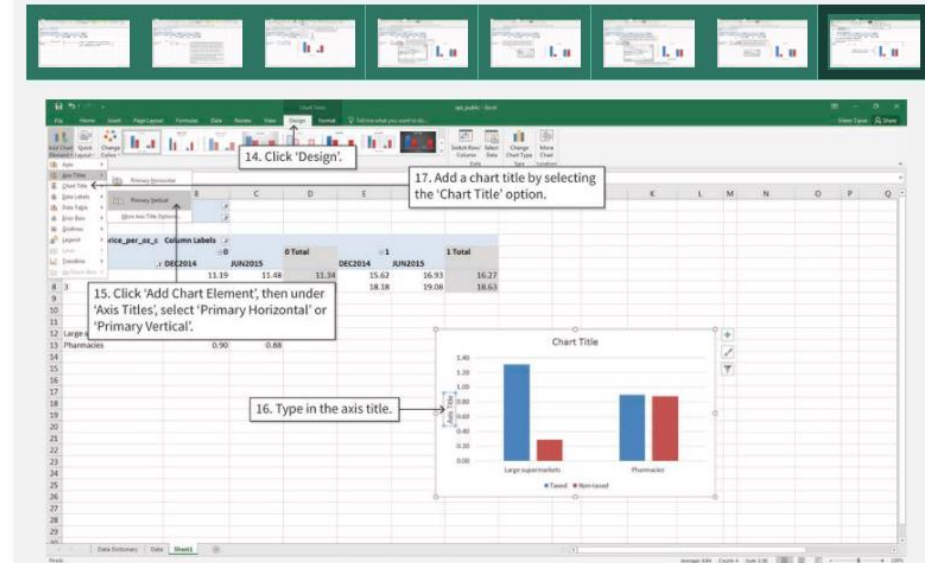
Introduction

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

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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

### 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



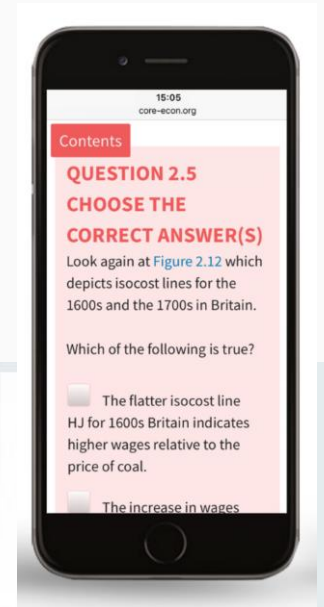
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Belinda Archibong, CORE-USA  
Barnard College, Columbia University

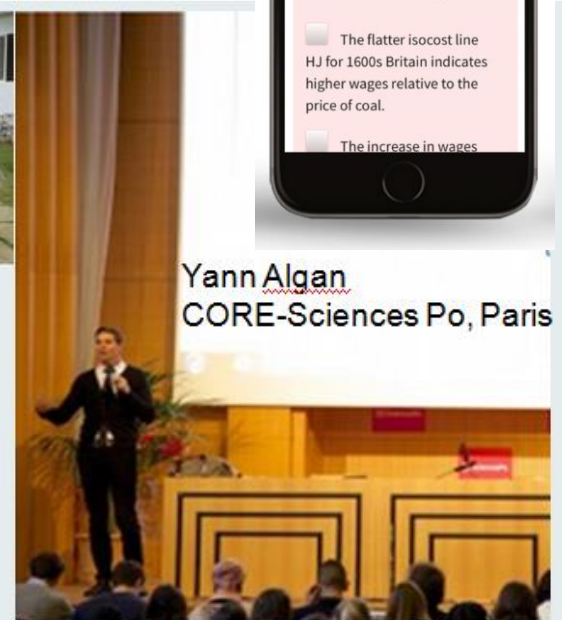
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**The Econ 101  
paradigm is broken  
– what is the  
alternative?**



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Yann Algan  
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Antonio Cabrales CORE-UCL

Wendy Carlin, UCL and CORE  
Irish Economic Association Conference 2018  
ESR Guest Lecture  
May 2018