How some economists think

by
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This presentation is NOT about oral sex*

apologies to The Undercover Economist

Where economists begin

• You react to pain and to pleasure
• You can’t live beyond your means…
• … forever

OR
1. People respond to incentives, purposefully
2. Budget constraints matter
3. People take interactions and the future into account
... towards:

- Behaviour isn't random but instead explicable and predictable
- The “economics of everything”
- Financial markets, labour markets, information markets, … markets for all kinds of goods and services
- Game theory
- Economic growth and income distribution

Our interest is in outcomes

- A famous writer and his fundamental question of economics:
  “Why do some places prosper and thrive…
  … while others just suck?”
Tradeoffs

1. “Do good in the world by doing well for yourself” Adam Smith and markets: Social gain aligned with individual incentive
2. Virtual and illusory
3. Substantive but not what many might think
4. Substantive and hard
5. Substantive and hard… to quantify

5. Substantive and hard to quantify

(1)
- Moral hazard: Greenspan put
  - Ex post vs. ex ante: Government bailout to keep financial market turmoil from harming broader economy
  - Allowing innovation vs. curbing excessive risk-taking

(2)
- Global warming
  1. Greenhouse gases cause global warming
  2. Global warming has massive deleterious effects on human welfare
  3. Greenhouse gas production strongly correlated with economic growth
  4. All else equal, economic growth is good
2. Virtual and illusory

- The Phillips curve

3. Substantive but not what many might think

- Inequality and growth
  - Kuznets curve
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**Inequality and growth**

Fig: The Kuznets curve, stylized.

**From even the Wall Street Journal**

**Annual earnings of US men, aged 35-44, in $2005**

<table>
<thead>
<tr>
<th></th>
<th>1973</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median</td>
<td>45785</td>
<td>40964</td>
</tr>
<tr>
<td>Mean</td>
<td>49705</td>
<td>54525</td>
</tr>
</tbody>
</table>

Source: Paul Krugman, 2007 Meade Lecture, LSE
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Figures:

1. **US College-High School wage ratio**

   Source: Paul Krugman, 2007 Meade Lecture, LSE

2. **World Poverty**

<table>
<thead>
<tr>
<th>Year</th>
<th>1981</th>
<th>1990</th>
<th>1999</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>World GDP 10^12 PPP$</td>
<td>24</td>
<td>33</td>
<td>43</td>
<td>52</td>
</tr>
<tr>
<td>GDP per capita PPP$</td>
<td>5408</td>
<td>6292</td>
<td>7231</td>
<td>8198</td>
</tr>
<tr>
<td>World’s poor 10^6</td>
<td>1470</td>
<td>1247</td>
<td>1109</td>
<td>969</td>
</tr>
<tr>
<td>China’s poor 10^6</td>
<td>634</td>
<td>374</td>
<td>223</td>
<td>128</td>
</tr>
<tr>
<td>Remainder 10^6</td>
<td>836</td>
<td>873</td>
<td>886</td>
<td>841</td>
</tr>
</tbody>
</table>

- PPP$ means constant International Dollars corrected for inflation and Purchasing Power Parity
- Poor means living on less than PPP$1/day

Source: Paul Krugman, 2007 Meade Lecture, LSE
4. Substantive and hard

- Intellectual property rights
  - Efficiency versus incentive
  - Nonrival goods
  - Identity and group consumption
  - Unlike property rights for all other goods and services
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IPRs on Facebook

Intellectual property rights
- Music, digital entertainment
  - MP3s, DVDs
- Computer software, operating systems
  - MS Windows, Linux
- Pharmaceuticals
  - AIDS antiretrovirals

Digital goods and services
- Global medication
  - HIV/AIDS infection: Africa 24.5m, total worldwide 34.3m
  - Population in Africa 12% of world
  - Cost of anti-retroviral medications
- Dynamic incentives versus monopoly markup: Creation versus dissemination
Creativity and dissemination

International IPRs
- India 04/1972-05/2003 pharma process patents only
- World's largest producer by volume, one of the world's largest for bulk drugs. Major exporter
- Quinolone molecules for bacterial infection
- Welfare loss US$715mn a year (120% of total sales) versus domestic producer profits gain US$50mn a year, multinationals US$57mn

Conclusions and emergent issues
- Tradeoffs
- Modeling
  - Behavioral
  - Constraints
  - Heroism
- Numbers
- Political economy
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