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 reason to believe they would have had no reason to believe my answer was based on any other source.

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

By Howard Reed / April 13, 2018 / Leave a comment

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

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

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

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
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
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
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.
Provide context – a century of decline in work hours …

... and cross-country evidence

Motivate income and substitution effects

Back to the data …
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.

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:

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

where $a$ and $\beta$ are positive constants. Anil’s marginal utilities are found as usual by partial differentiation:

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

His marginal rate of substitution (the absolute value of the slope of the indifference
Motivation and role models

EXERCISE 17.9 BANKING REGULATIONS CAN HELP BRING ON FINANCIAL CRISSES
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)

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 opera.

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?

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

EXERCISE 3.1 CHOOSE THE CORRECT ANSWER(S)
According to the ‘Economist in action’ video featuring Esther Duflot:

- 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.
- Duflot 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
What is the most pressing issue that economists today should address?
What is the most pressing issue that economists today should address?
Inequality

Globalisation

Global Warming

Brexit

Poverty

Secular Stagnation

Social Welfare

Low Growth

Old Theory

Slow Economic Growth

Growth Stability

Technology

Income Inequality

Sustainable Development

Consumer Preferences

Population

Automation

Inflation

Financial Stability

Promoting Opportunity

Predicting Future

Ineffective Central Bank Policy

Credit Cycle

Low Interest Rates

Economic Growth

Too Big To Fail

Opportunities Everyone

Technological Unemployment

Methodology

Diversity

Global Inequality

Productivity Growth

Productivity

Stability

Absolute Poverty

Wealth Inequality

Growth

Wage Growth

Robots

Population Growth
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

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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.
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

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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

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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.
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

Gini, Rover 0.06
Gini, Favourite 0.63

Cumulative share of the ship's company from lowest (crew) to highest income (captain) (%)
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?

<table>
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<tr>
<th>Scenario</th>
<th>The Model: Angela and Bruno’s interaction</th>
<th>Real-world examples</th>
</tr>
</thead>
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<tr>
<td><strong>A</strong></td>
<td>Independence: Angela works the land on her own, and everything she produces is hers.</td>
<td>Independent farmers with access to land (either free, or because they own it) have been common in history ever since farming began.</td>
</tr>
<tr>
<td><strong>B</strong></td>
<td>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.</td>
<td>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.</td>
</tr>
<tr>
<td><strong>C</strong></td>
<td>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.</td>
<td>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.</td>
</tr>
<tr>
<td><strong>D</strong></td>
<td>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.</td>
<td>Capitalism and democracy in the 20th century and today. Operation Barga in Bengal changed the rules and was the result of political pressure in a democracy.</td>
</tr>
</tbody>
</table>
Figure 5.6. Economically feasible allocations when exchange is voluntary.

- Angela’s biological survival constraint
- Angela’s reservation indifference curve
- Feasible frontier: Angela and Bruno combined
- Economically feasible set
- $Z$: Angela’s reservation option
Bargaining in practice: A land tenure reform in West Bengal reduced the Gini coefficient.

Initial Gini coefficient: 0.40
Gini coefficient after land tenure reform: 0.15

![Lorenz curve shifts due to land tenure reform](chart.png)
Evaluation: every economic transaction involves both mutual gains & conflicts of interest
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.
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.’
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?

Employer

Employee

UNIT 6
THE FIRM: OWNERS, MANAGERS AND EMPLOYEES
Work effort is not contractually enforceable: An employee’s best response to the wage.

Worker’s best response curve when expected unemployment duration is 44 weeks.
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 employment 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 the firm to track the productivity of workers would adjust.

It also allowed Lazear and his colleagues to use the firm’s data to analyse the effect on worker productivity of the worst national economic 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.
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 ⇔ Macro ➔ Inequality
Aggregate demand and fluctuations – a second principal-agent problem

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

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

2. Employees’ power falls relative to owners

Always ask: what has happened to the bargaining gap?

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

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.

Read more here on the CORE blog
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.

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

A bubble in the housing market

Price of housing, $t$

A tipping point in the housing market.

An environmental tipping point

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

Price unchanged from year to year

Initial high stable equilibrium
(Extensive summer sea ice)

The last tipping point disappears

The line of unchanging environment

EDCurves shift down as climate change reduces winter ice

The last tipping point disappears and environmental collapse to the equilibrium without summer sea ice occurs

Low stable equilibrium
(No summer sea ice)
A paradigm in economics has to take a position on

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<td>Always-changing process embedded in society &amp; biosphere</td>
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<td>Also, have social preferences, respond to norms; are principals and agents</td>
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<td>Perfectly competitive markets</td>
<td>Also, price-making, strategic and non-market interactions associated with static &amp; dynamic economic rents</td>
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<td>Include dynamic responses and pervasive external effects</td>
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<td>Of central concern</td>
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Back to problems, paradigms and texts: Samuelson incorporates aggregate demand

Samuelson 1948 = Marshall + Keynes

Aggregate demand

Strategic interaction

Information is scarce and local
Back to: Problems, paradigms and texts

Aggregate demand

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

Exit, voice, and loyalty in the economy, society & politics
Albert Hirschman
*The Economy* Unit 22

Power, human motivation and organizations
Herbert Simon
*The Economy* Units 4, 5, 6, 20, 22

Social norms and managing common property
Elinor Ostrom
*The Economy* Units 4, 12, 20
The CORE ebooks

Replaces traditional Econ101
Micro and macro
Calculus supplements (Leibniz)
+ 6 capstone units

Aimed at non-economics specialists
Public policy orientation
Undergrad or public policy masters

Hands-on step-by-step data handling and analysis projects
Using Excel or R
Linked to ESPP (& The Economy)
What’s new from the CORE team?

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THE CORE ESPP TEAM

ECONOMY, SOCIETY, AND PUBLIC POLICY BETA

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

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

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