Order of business

- Return of manufacturing to U.S.?

- Broader applications of consumer theory in social sciences. Rational Choice Theory and Crime

- Application of consumer theory to food stamps

In Reading 6

- We saw that manufacturing in industries characterized by low-skilled or semi-skilled workers doing routine tasks has been migrating to China

- Has this changed in recent years?

- September 2013 article, "A Wave of Sewing Jobs as Orders Pile Up at U.S. Factories"
  - http://www.nytimes.com/2013/09/30/business/a-wave-of-sewing-jobs-as-orders-pile-up-at-us-factories.html?_r=0

Return of Manufacturing?

- Textile manufacturing shifting back to U.S.
  - Is Minneapolis the new North Carolina?
- Customers asking for U.S. made goods
  - Higher quality
  - Reliable delivery schedules
  - Fewer safety problems (factory collapse in Bangladesh)
- Costs in China rising: Airtex (Minneapolis firm)
  - 2000: started sending production to China for $3 per hour for Chinese workers
  - Today: $11.80 per hour for Chinese workers
  - US workers: $9-$17 per hour plus benefits (Benefits are about 30% of wages)

3

Return of Manufacturing?

- Problem? Not enough workers.
  - As jobs moved to China, U.S. workers stopped learning skills to work in textile industry

- How can U.S. firms find and train qualified workers in industries that shipped almost all production overseas?
  - Raise wages
  - Customized training programs/partnerships with schools
  - Immigrant workers

4

Rational Choice Theory and Crime

- This course satisfies liberal education requirements for social science. As such, it is useful to discuss the place of economics more generally in social science.

- The approach of economics, modeling decision makers as rational agents solving a maximization problem, subject to constraints (like maximizing utility subject to a budget constraint), has had wide application in social science.

- In sociology, it is applied to analyze criminal behavior. This branch of sociology (or criminology) is called rational choice theory.

5

- It is also applied to analyze family decisions (whether or not to get married, have a kid,....)

- In political science it is applied to analyze whether or not an individual votes. And if the individual votes, it is applied to study how the individual votes.

- Let's work through a simple example of rational choice theory applied to the analysis of the incentive to commit a crime. In addition to illustrating the point, the example provides a nice review of income and substitution effects.

Freddie has 10 hours a day to work.
Can earn $1 an hour through honest means
Initially can earn $2 an hour through dishonest work (e.g. selling drugs)
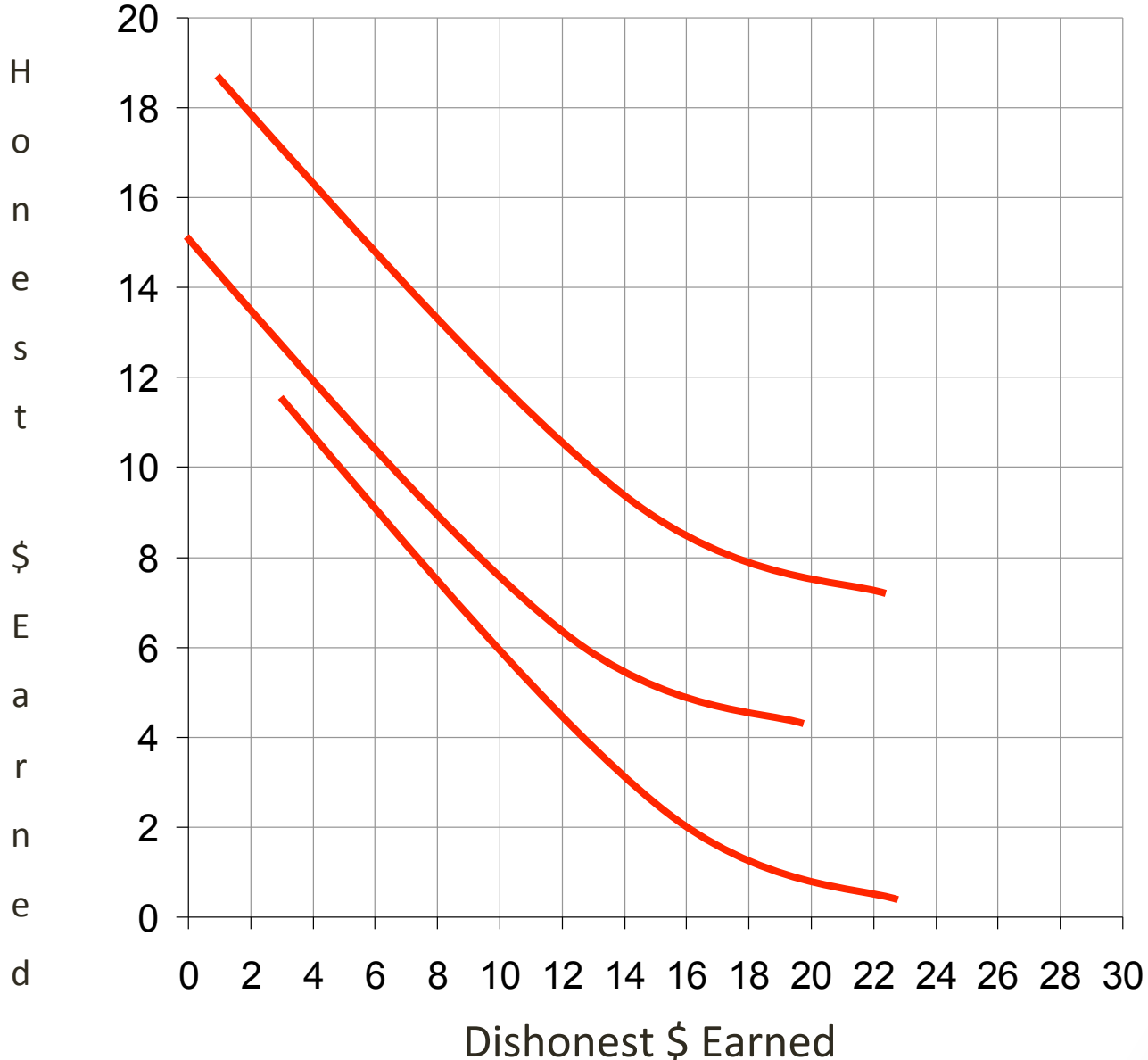The graph shows Freddie's indifference curves between honest and dishonest money
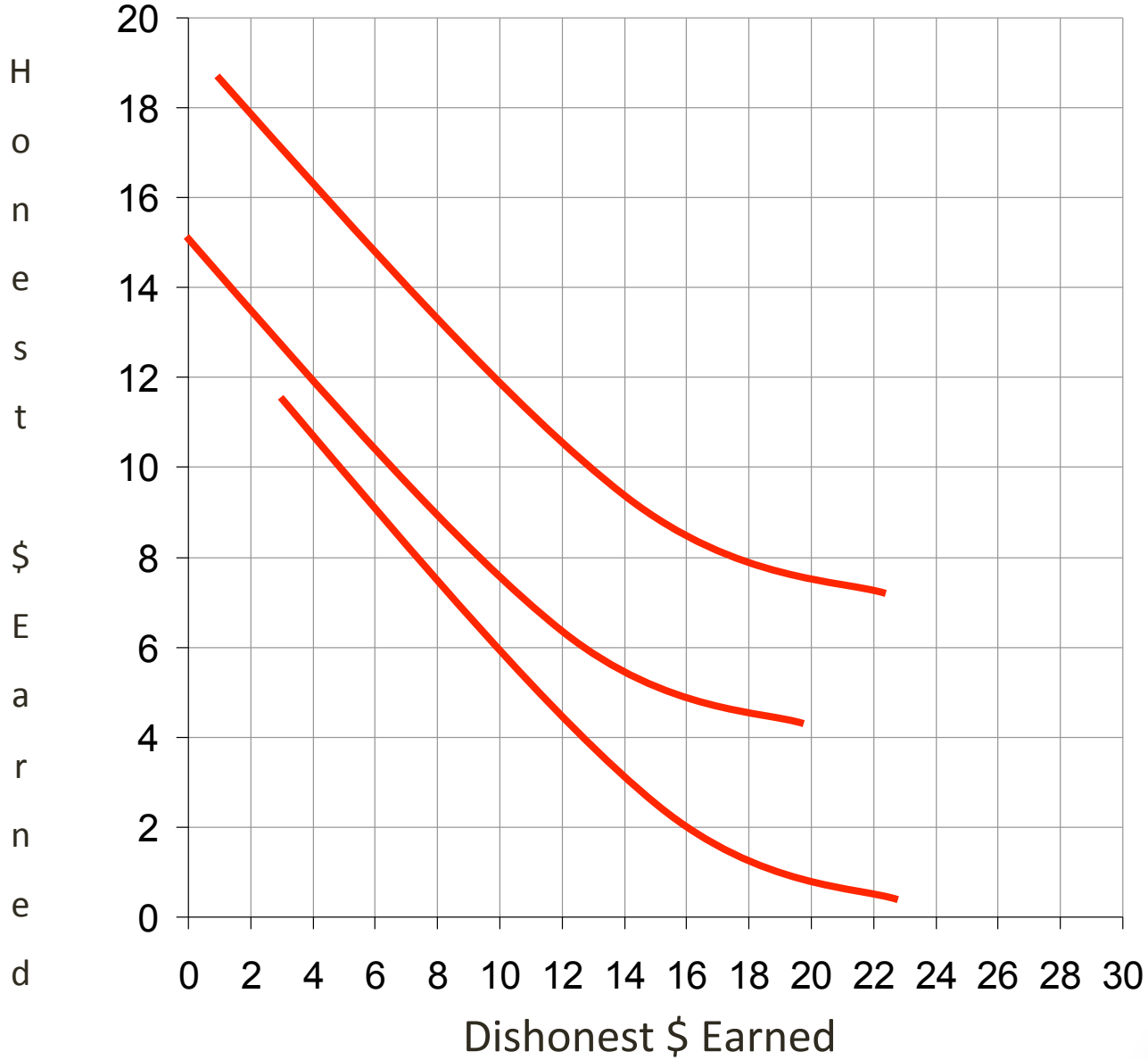
Honest $ Earned (y-axis)

Dishonest $ Earned (x-axis)

7

Freddie has 10 hours a day to work.

Can earn $1 an hour through honest means

Initially can earn $2 an hour through dishonest work (e.g. selling drugs)
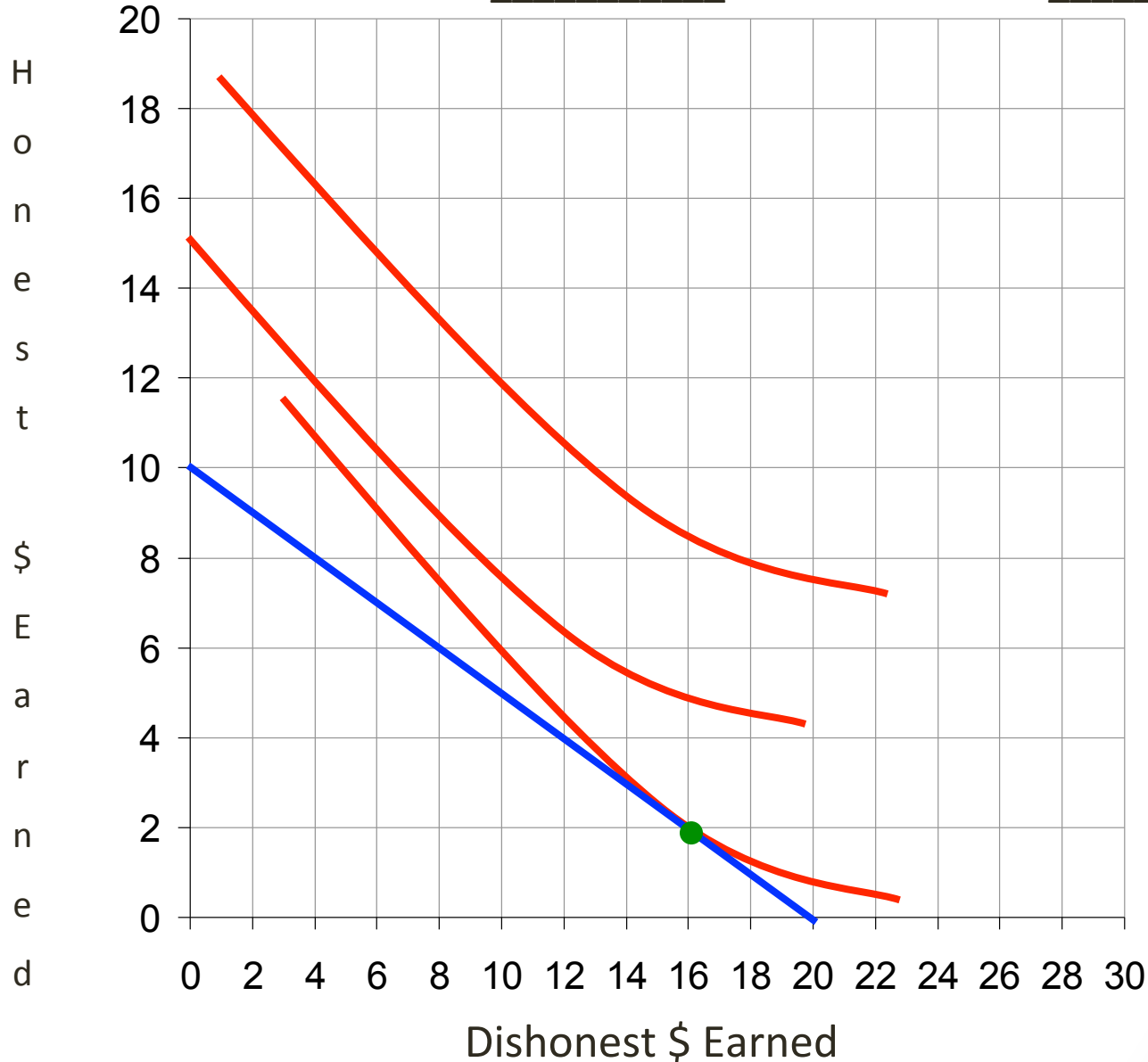
Plot Freddie's budget constraint

Honest $ Earned

Dishonest $ Earned

Can earn $1 an hour through honest means
Initially can earn $2 an hour through dishonest work
Optimal choice of dishonest $ earned is _____ and honest $ earned _____
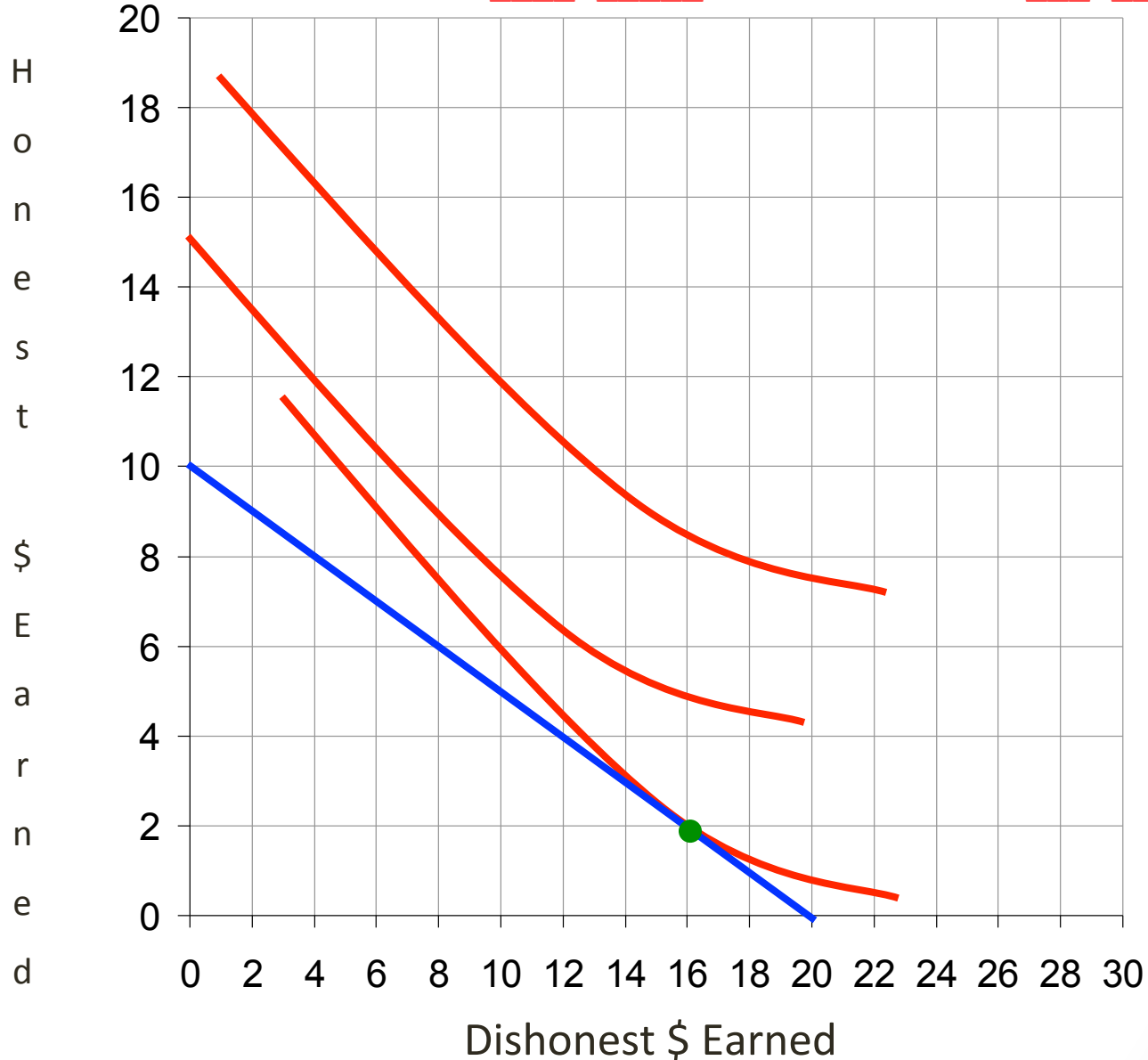Optimal choice of dishonest hours _____ and honest hours _____

Honest $ Earned

Dishonest $ Earned

9

Can earn $1 an hour through honest means
Initially can earn $2 an hour through dishonest work
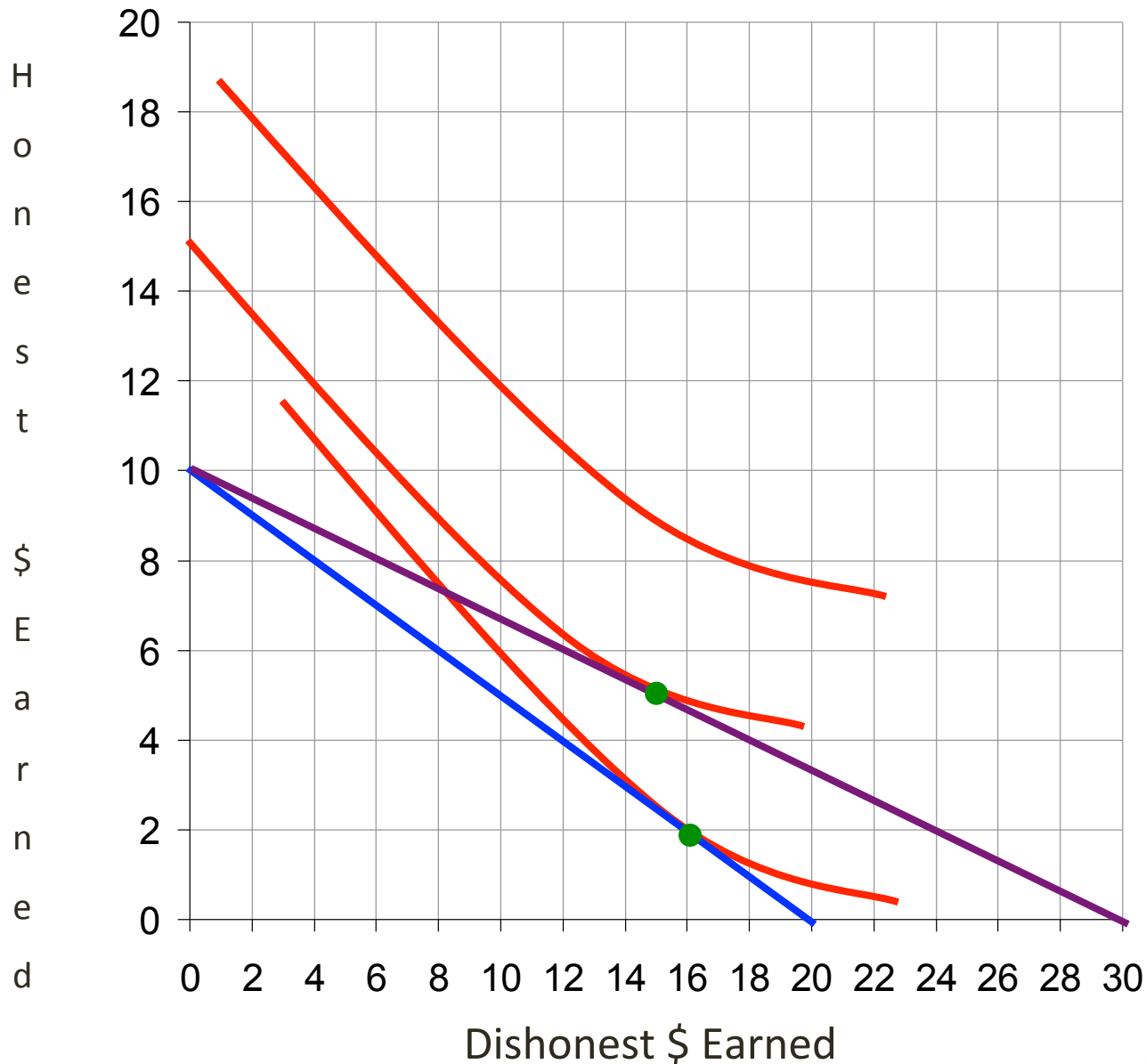Optimal choice of dishonest $ earned is __16__ and honest $ earned __2____
Optimal choice of dishonest hours ____8_____ and honest hours ___2____

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Dishonest $ Earned

Now suppose can earn $3 for dishonest work instead of $2
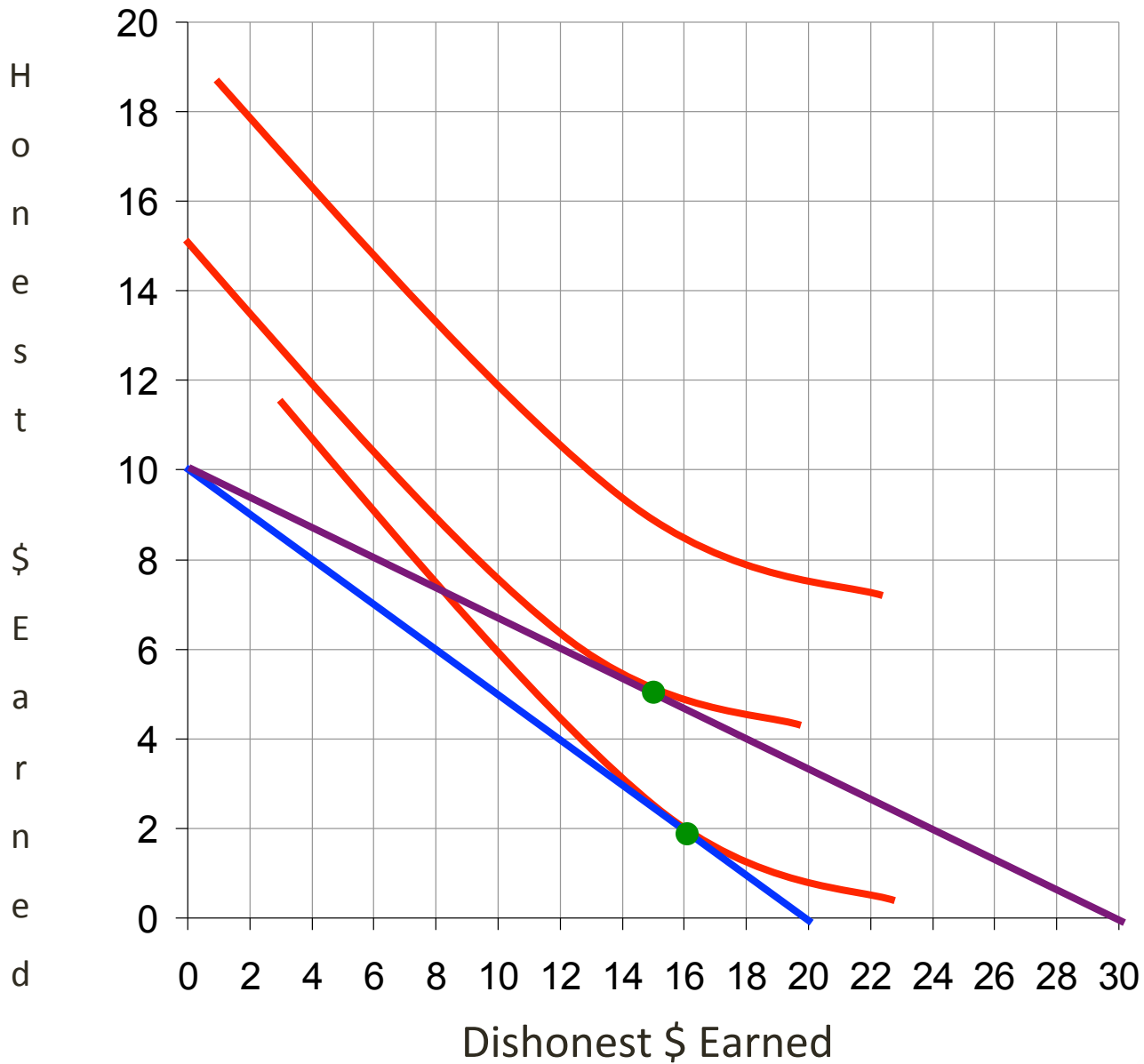Optimal choice of dishonest $ earned is _____ and honest $ earned _____
Optimal choice of dishonest hours _____ and honest hours _____

Now suppose can earn $3 for dishonest work instead of $2

Optimal choice of dishonest $ earned is __15___ and honest $ earned __5____

Optimal choice of dishonest hours ____5_____ and honest hours __5____

Honest $ Earned

Dishonest $ Earned

12

- The return to dishonest work goes up, but Freddie chooses to commit less crime and spends more time on honest work!

- Think about this in terms of an income and substitution effect.

- Dishonest income is an ___inferior_____ good.

Income and substitution effects for Freddie

We can double check the previous analysis with our usual tools:
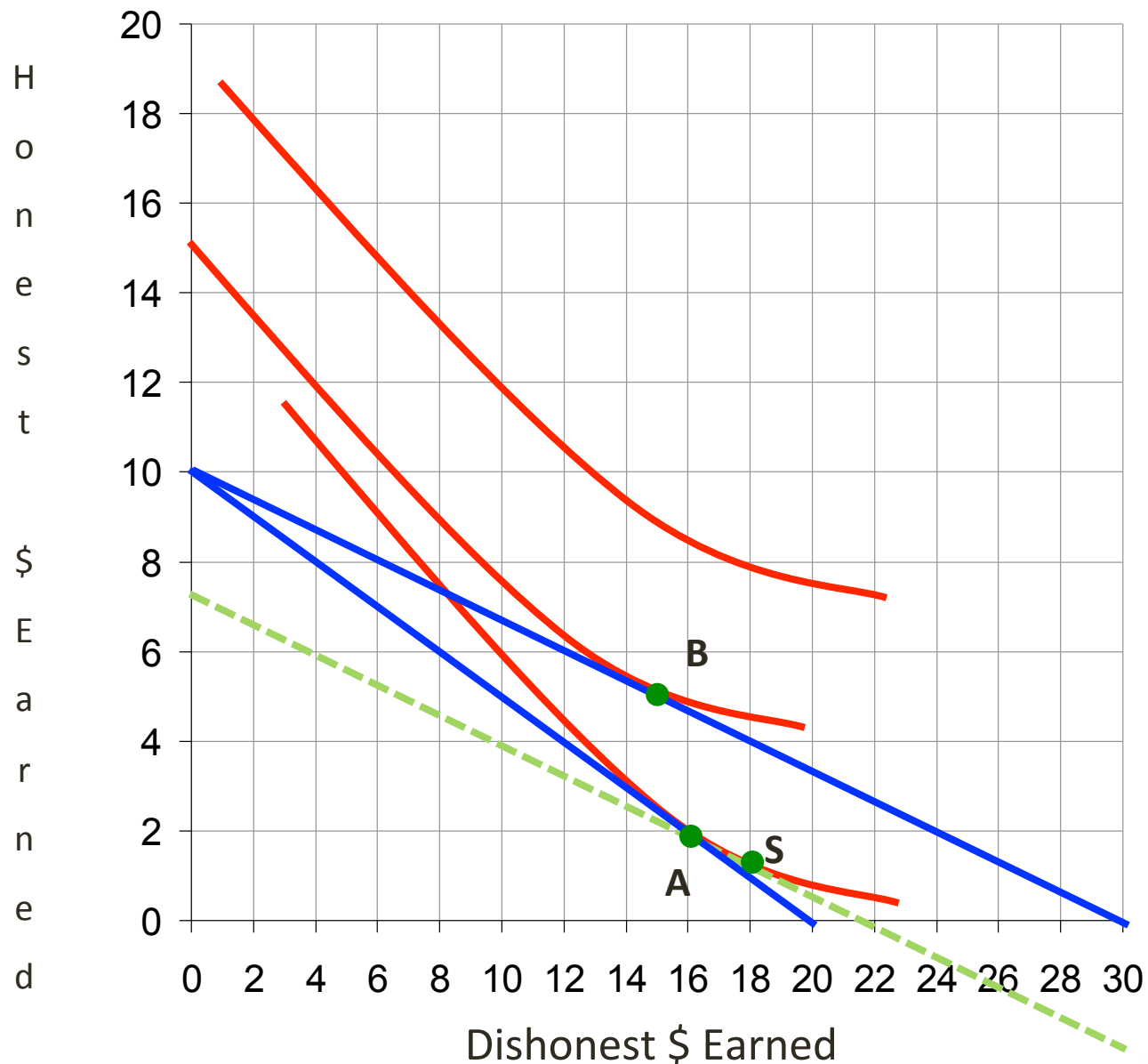
Give Cash Instead of Food Stamps?

Go back to our earlier case where Goldy has an income of $24 and faces prices:

- P_{pizza} = $4, P_{beer} = $2

We will use the "OCB" framework now to analyze subsidies

- Suppose President Kaler (the government) offers Goldy pizza stamps worth $3 per pizza (subsidy, like food stamps)

- The effect of this policy is a change in Pp:
  - so effective price faced by Goldy is P_{pizza} = $1.
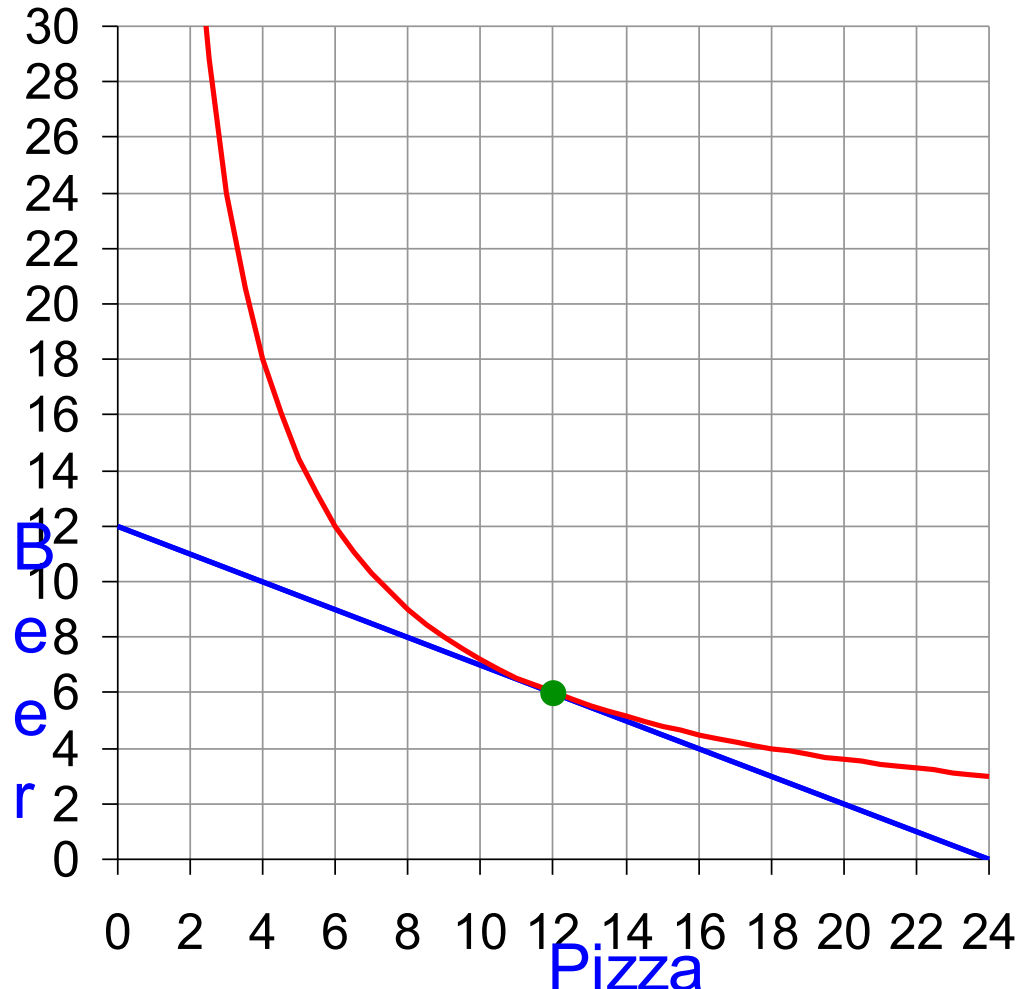
Choice with pizza stamps (subsidy)

Draw BC and given goldys indifference curves we find OCB

Optimal consumption bundle (OCB):
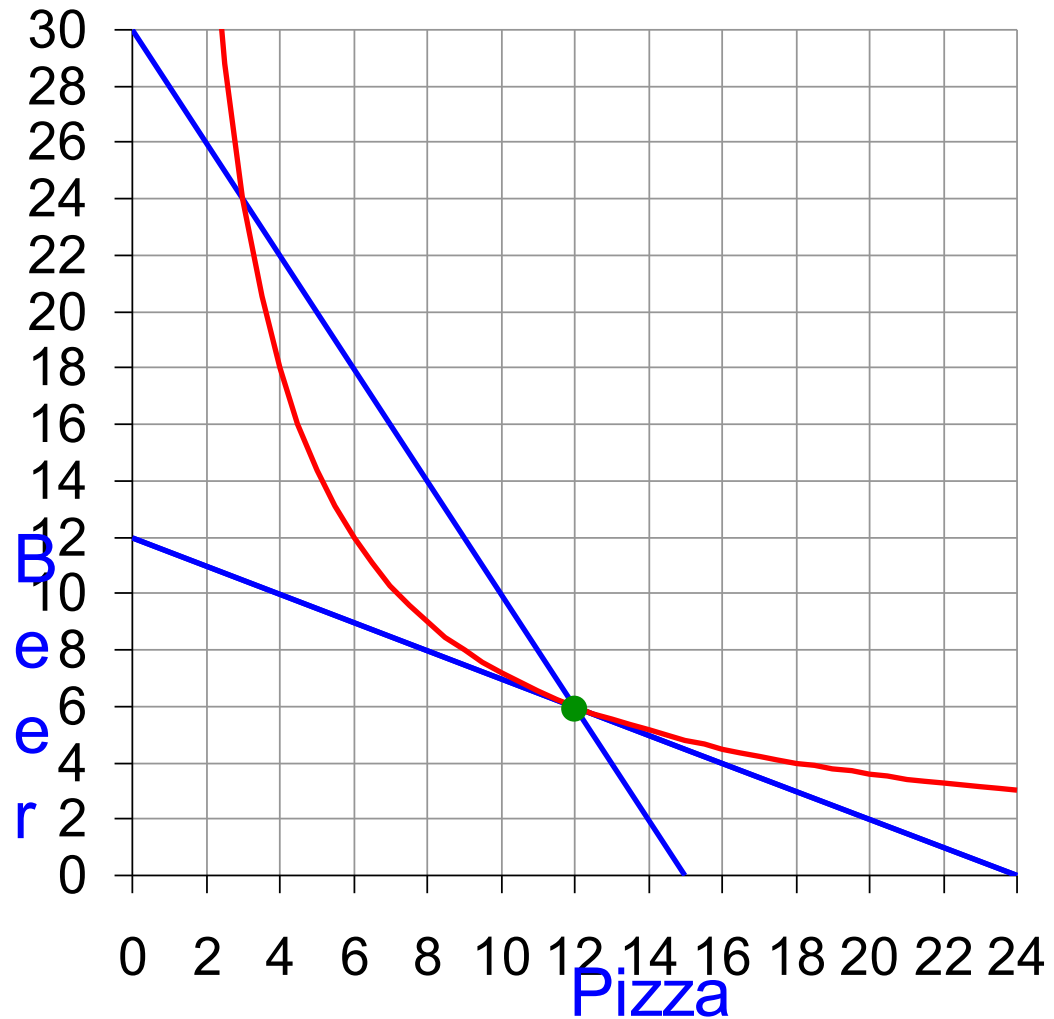
12 pizza, 6 beer

Costs government: $3×12 = $36

16

Let's compare this with a lump sum transfer

Suppose instead of pizza stamps the government gives $36 in cash:

The effect of this policy is a change in income: (so Goldy has $24+$36 = $60)

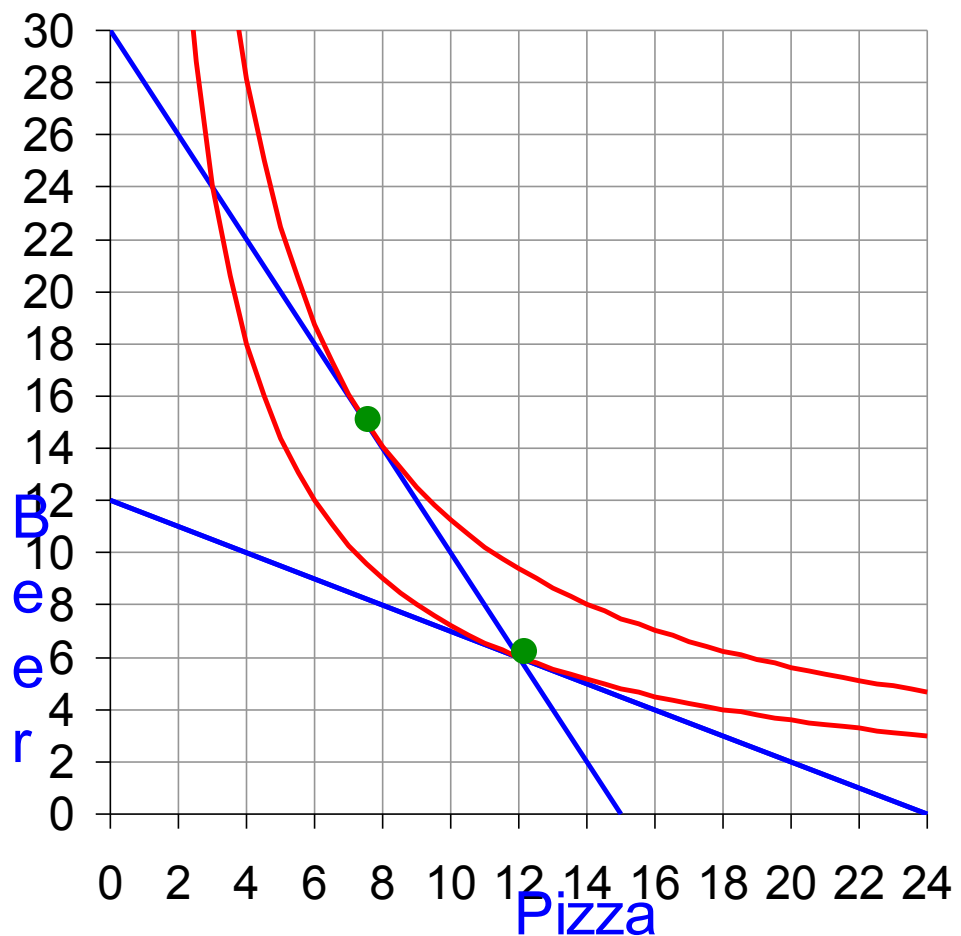Budget constraint goes through original choice but with new slope.

Get to new higher level of utility!

A higher indifference Curve so goldy is better off

OCB: Consume:

- 7.5 pizza, 15 beer

18

Switching from stamps to cash is a Pareto improvement

Goldy better off with cash.

- The Government (Kaler) spends $36 either way

- Give cash, get Pareto improvement!

- Same point from before that subsidies lead to deadweight loss. But fancier pictures!

So can we say based on this diagram that food stamps are a really bad idea?

Some reasons why we use food stamps:

What is this analysis missing?

(i)   Externalities?

Suppose Goldy has kids. We want him feeding them pizza, not beer!

- Pizza stamps (food stamps) not so bad.
- We want the subsidy to be used in the purchase of a specific good

(ii) Can be difficult to tell who needs help. So providing a homeless shelter (rather than giving cash) sorts out people who need it.

Midterm 2 tips

Look over lecture slides.

Do the practice tests.

Know how to do the three worksheets.

Read the three readings on Moodle (Readings 4, 5, and 6)

Ask if you have any questions (Q & A sessions, office hours).