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Catching Up on Keynesian Economics

By Matt Ravet

Since the change of administration in January, John Maynard Keynes and his brand of economics have been talked about with increased frequency. My dad, who occasionally calls me to ask his econ-related questions, rang to ask what I thought of Keynesian economics and the American Recovery and Reinvestment Act of 2009 (the new stimulus bill). Despite having nearly finished my Economics degree, I was unable to come up with a meaningful response. I said something about the Great Depression and FDR. I tried to explain why I wasn't able to come up with a better response by saying I was getting my Bachelor of Science degree and didn't spend a lot of time with economic theory, but I think my dad probably still suspects me of skipping class. So, in an effort to help others avoid this situation with friends, family, or passersby, I've compiled some information on Keynes and his contributions to economics.

Keynes' most influential ideas were developed and published in the 1930s in the midst of the Great Depression. Accordingly, he focused on developing methods to improve the ailing Western economies. Keynes' strategies diverged from those of his predecessors; previous economists harped on increasing the amount produced, whereas Keynesian economics casts a new light on the importance of bolstering demand. To increase demand, Keynesian economics emphasizes the creation of incentives that reduce "excess" savings and the injection of more money into the economy by creating jobs. The government serves as the catalyst for these changes, delivering tax cuts and increasing public spending. The idea is to give the consumers more money to spend to increase demand, causing producers to need more employees to keep up with demand. This further increases the amount of money...

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Auto Industry Bailout

By Stanley Jiang

After serving America loyally for over a hundred years and creating millions of jobs, the auto industry giant General Motors is finally stepping down from the spotlight and facing one of the toughest decisions today: restructuring or bankruptcy. In the current economic climate, even the top American automobile maker cannot escape from problems of low liquidity and high debt. According to recent press releases, GM is short on cash and requires external funding before April to resurface from its financial hole. The company recently requested \$18 billion in security loans and an additional \$4.5 billion on credit.

For the U.S. government, this simple request is like adding oil to a fire. The \$30 billion financial aid to the auto maker was never part of the \$700 billion bailout plan passed in October. If implemented, GM's financial aid package will be yet another burden to the federal government over the next couple of years. This strain might require Congress to raise federal taxes as well as trim budgets in coming years. Even though this financial situation is generally avoided, our government has been left with no choice but to rescue GM: if action is not taken soon to prevent GM's collapse, millions of workers will become jobless. These job cuts could cause the unemployment rate to increase from 7% to an estimated 9.3%. Many fear that this downward spiral could deepen the economic crisis.

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What Price is a Dollar?

By Zilai Li

From THINKING STRATEGICALLY by Avinash K. Dixit and Barry J. Nalebuff

Yale Professor Martin Shubik designed the following game of entrapment. An auctioneer invites bids for a dollar. Bidding proceeds in increments of five cents. The highest bidder gets the dollar, but both the highest and the second highest bidders pay their bids to the auctioneer.

Professor Shubik may have made small profits – enough for a lunch or two at the faculty club – from unsuspecting undergraduates playing this game in classroom experiments. Suppose the current highest bid is 60 cents and you are second with 55. The leader stands to make 40 cents, but you stand to lose your 55. By raising to 65, you can put the boot on the other foot.

How would you play this game?

Answer: This is an example of slippery slope. Once you start sliding, it is hard to recover. It is better not to take the first step unless you know exactly where you are going.

The game has one equilibrium, in which the first bid is a dollar and there are no further bids. But what happens if the bidding starts at less than a dollar? The escalation has no natural limit other than the amount of money in your wallet. The bidding must stop when you run out of money. That is all we need to apply the rule: Look forward and reason backward.

Of course there is a much simpler and more profitable solution for the students: collusion. If the bidders agree among themselves, a designated person will bid five cents, no one else will bid at all, and the class will share the profit of 95 cents.

There are many similar real world examples to think about, such as the escalation of the superpowers' nuclear arms arsenals. Nations have incurred trillions of dollars in costs in quest of the "dollar" of victory. Collusion, which means peaceful coexistence, is a much more profitable solution.

Check out the international study abroad programs sponsored by the Department of Economics:

There are still spots available for the University of Marseille and University of Munich programs, and possibly for Bolzano, Tilburg or Thammasat. For more information, please check with an adviser by emailing econdadv@u.washington.edu.

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Adam Smith - the father of economic study.

Catching up...

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...consumers have to spend. This feedback loop, widely referred to as the “multiplier effect,” is one of the main motivations for government intervention. There is obviously a lot more to Keynesian economics, but this information is key to following what is on the news today.

The concepts and mathematics of Keynesian economics are fairly straightforward, yet there is no consensus as to whether or not Keynesian policies are effective. FDR’s New Deal policies, based on the fundamentals of Keynesian thought, were largely credited for defeating the Great Depression. However, a fair amount of debate persists, since one could argue that World War II was really what pulled America out of the Depression. That aside, Keynesian principles completely failed in the 1970s. Instead of alleviating symptoms of the recession, the government’s actions were accompanied by rampant inflation. The problem with Keynesian economics is that the effects of these policies can only be observed during times of recession or depression, so Keynes’ theories haven’t had many opportunities to prove, or disprove themselves.

The inconclusive results with respect to Keynesian policies makes the discussion of the effectiveness of Keynesian principles a heated one, but the debate today seems to be primarily politically motivated. Republicans utilized supply-side economic policy, or “trickle-down economics,” whereas the Democrats favor the demand-side actions, like the stimulus bill. So where exactly does this leave us? That is a question I’m not prepared (or qualified) to be answering. After all of this, I’m still not exactly sure how I feel about Keynesianism. With the issues as complicated as they are, the only thing I can suggest is to be wary of the information presented by the media, as the debate has become a partisan one, so everyone has an agenda.

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Is the financial bailout reasonable? Some might feel that this is against the reasoning of free market and key principles of economics, however, the bailout is essential to millions of auto workers in US. Without further question, it is clear that millions of workers depend on the auto giant for employment in order to pay off expenses, mortgages among the largest. If the automaker cannot stand the heat of the crisis, then millions of workers will face foreclosure of their homes leaving Wall Street in further trouble. This will have a devastating effect on our already shaky economy.

Even if the government makes the decision to save General Motors, this dilemma may still persist for other companies that are still waiting for federal help. And of the companies, how may will look for federal support? First Freddie Mae and Fannie Mac, then AIG and now General Motors. Each of them has knocked on the treasury’s door, as if it was a continuous money tree, asking for government bail out. If today’s stimulus package is insufficient, will all financial giants be expecting this same support? And if so, will there ever be an end to the bailouts? For now the answer is uncertain and the greatest hope lies in the success of our new president. But until change comes, it may be best to pinch those pennies and prepare for the worst.

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Investing in Collectibles

By Claudia Li

Everything is game when it comes to labeling an item as a collectible. Prospective items range from sport cards, fine art, comics, stamps, even toy figurines from your childhood. While possibilities are limitless, buying “collectibles” for the sole purpose that they will appreciate in the future is risky. Value depends on a multitude of factors including the tastes of an individual and rarity. There is no reassurance any collectible will be desired in the future, thus jumping into the trade of buying and reselling collectibles is tricky. Luckily, the “junk” you’ve already accumulated at your home may have some emotional nostalgia value for another individual willing to pay top dollar.

Did you collect Pokémon cards or Beanie Babies when they were all the rage in the ‘90s? Unfortunately, those are examples of items that were just fads. Their popularity was only for the moment, and although some individuals were able to profit off of them in the short-run, you will be at a loss these days. So what is deemed a collectible? There’s no concrete definition separating it from rubbish, but for the average consumer, we spend money on items we want--not for the intention of investing, especially when we were children. Perhaps we can only rely on luck to determine if items we wanted during our youth will become collectibles in the future.

Don’t get your hopes down yet! There are still other “junk” items you may have that are worth selling. How about toy figurines? Both my mother and I thought my brother, a college student at the time, was crazy when he raided our home for his old Transformer figurines from the ‘80s. It turns out with the release of the 2007 Transformers film; there was an increased demand for consumers who craved those nostalgic figurines from their childhood. He was able to sell what he had for at least a few hundred each--not so crazy after all, especially when you’re a college student.

Also, keep in mind the items you may have inherited from parents or friends. Magazines or comics are easily accumulated items, and while some may belong in the dumpster, watch out for those that are timeless such as Mad magazine, or Action Comics with the introduction of one of America’s most iconic superheroes, Superman. Some issues may only be worth a dollar or two, but there are collectors willing to pay hundreds to thousands of dollars depending on the condition and rarity of your items.

The weaknesses of intentionally investing in some collectibles will most likely outweigh the benefits, especially compared to stocks or bonds. But don’t make any regrets tossing out your “junk” that would potentially have a big payout! Look through your possessions carefully and do research before attempting to sell anything. If you have boxes of items waiting around to be tossed, why not check to see if any can be turned into a profit? As the saying goes, “one man’s junk may be another man’s treasure.”

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