Course 1 - Introduction to the Economics of Superstars

UCLA - Econ 19 - Fall 2018

François Geerolf

Contents

1 Presentation of the class

1.1 Basic Information

Classes: Tuesdays 2-3:50 pm. Sessions every two weeks, starting Week 1: Oct 2, Oct 16, Oct 30, Nov 13, Nov 27. Bunche Hall 3170. *To pass this class, you are required to come to all five classes from beginning to end (per university regulation, because our classes are 2-hour classes). Please make sure you can make all five dates before you enroll in this class.*

Class Website: https://fgeerolf.github.io/teaching/ECON19/

Course description. Tim Cook, Marissa Mayer, Bradley Cooper, Angelina Jolie, Tiger Woods and Katy Perry all earned more than 10 million dollars last year according to Forbes. That is more than 300 times the median wage in the United States. Can economics make sense of these orders of magnitudes? Who among a famous singer, a CEO running an international organization on several continents, an entrepreneur creating Microsoft, Apple or Facebook, or a successful Wall Street trader, creates more "economic value"? Should inventors, top managers and CEOs be rewarded more than rock stars or professional athletes? What are the arguments for and against counteracting the corresponding increases in inequalities through taxation or other government interventions? Can we expect the rising "winner-takes-all" trend to continue? The Fiat Lux class *Economics of Superstars* should be a playful way to first approach basic economic concepts (optimality, incentives, Pareto distributions, public goods, complementarities, etc..), and to test the power of economic reasoning as well as its limits.

Grading. P/NP basis, based on attendance and 30 mn presentations by groups of 2 or 3, during the last two sessions (Week 7 and Week 9).

1.2 Presentations

The material for presentations during the last 2 classes can be found in the following eight academic articles. These are articles from the *Journal of Economic Perspectives*, in complimentary access from the American

Economic Association's website. They will be assigned on a first come, first served basis. Please email-me the number of the paper you wish to present, as well as the name of your partner(s):

1. Alvaredo, Facundo, Anthony B. Atkinson, Thomas Piketty, and Emmanuel Saez. "The Top 1 Percent in International and Historical Perspective." Journal of Economic Perspectives 27, no. 3 (September 2013): 3–20.
2. Kaplan, Steven N., and Joshua Rauh. "It's the Market: The Broad-Based Rise in the Return to Top Talent." Journal of Economic Perspectives 27, no. 3 (September 2013): 35–56.
3. Bivens, Josh, and Lawrence Mishel. "The Pay of Corporate Executives and Financial Professionals as Evidence of Rents in Top 1 Percent Incomes." Journal of Economic Perspectives 27, no. 3 (September 2013): 57–78.
4. Mankiw, N. Gregory. "Defending the One Percent." Journal of Economic Perspectives 27, no. 3 (September 2013): 21–34.
5. Corak, Miles. "Income Inequality, Equality of Opportunity, and Intergenerational Mobility." Journal of Economic Perspectives 27, no. 3 (September 2013): 79–102.
6. Bonica, Adam, Nolan McCarty, Keith T. Poole, and Howard Rosenthal. "Why Hasn't Democracy Slowed Rising Inequality?" Journal of Economic Perspectives 27, no. 3 (September 2013): 103–24.
7. Philippon, Thomas, and Ariell Reshef. "An International Look at the Growth of Modern Finance." Journal of Economic Perspectives 27, no. 2 (May 2013): 73–96.
8. Haskel, Jonathan, Robert Z. Lawrence, Edward E. Leamer, and Matthew J. Slaughter. "Globalization and U.S. Wages: Modifying Classic Theory to Explain Recent Facts." Journal of Economic Perspectives 26, no. 2 (May 2012): 119–40.

1.3 Lighter Readings

The following pieces are written by academic economists for a broader audience:

Kenneth Rogoff. "Public Applauds Huge Salaries for Sports Stars while Business Stars Get Abuse." *The Guardian*. March 2, 2012.

Alan B. Krueger. "Land of Hope and Dreams: Rock and Roll, Economics, and Rebuilding the Middle Class. Remarks at the Rock and Roll Hall of Fame." June 12, 2013.

Paul Krugman. "Trade and Inequality, Revisited." *Vox EU*. June 15, 2007.

1.4 Press articles

The rise in top incomes is very much in the news these days. Here is a choice of press articles on the subject:

Eduardo Porter. "How Superstars' Pay Stifles Everyone Else." *New York Times*. December 26, 2010.

John Cassidy. "Forces of Divergence." *New Yorker*. March 31, 2014.

Lizzie Widdicombe. "The Programmer's Price." *New Yorker*. November 24, 2014.

1.5 Book Readings

To go further, you may want to read the following related references:

Piketty, Thomas. Capital in the Twenty-First Century. Harvard University Press, 2014.

Goldin, Claudia, and Lawrence F. Katz. The Race Between Education And Technology. Harvard University Press, 2008.

Moretti, Enrico. The New Geography of Jobs. Houghton Mifflin Harcourt, 2012.

Stiglitz, Joseph E. The Price of Inequality: How Today's Divided Society Endangers Our Future. W. W. Norton & Company, 2012.

1.6 To go further (optional)

My goal will be to try to convey economic intuitions with the minimum amount of mathematical formalism. However, you may want to try reading the corresponding academic articles yourself. They are very often very mathematical, and I certainly do not expect you to understand their technical derivations. But the introductions and conclusions usually translate the mathematics into words, and can actually be fascinating to read. For example, I advise you to read Sherwin Rosen's introduction to his AER article The Economics of Superstars. (it is the first reference below) You should also find Handbook chapters and to a lesser extent, the Annual Review of Economics, way more accessible. Again, clicking on the titles should redirect you directly to a download page. Should the links be dead, the articles are also available from a computer connected to the UCLA Wifi, for example through Jstor http://www.jstor.org/ or directly on Google Scholar https://scholar.google.com/:

Marshall, Alfred. Principles of Economics. Palgrave Macmillan, 1890.

Rosen, Sherwin. "The Economics of Superstars." The American Economic Review 71, no. 5 (1981): 845–58.

Krueger, Alan B. "The Economics of Real Superstars: The Market for Rock Concerts in the Material World." Journal of Labor Economics 23, no. 1 (January 1, 2005): 1–30.

Connolly, Marie, and Alan B. Krueger. "Chapter 20 Rockonomics: The Economics of Popular Music." In Handbook of the Economics of Art and Culture, edited by Victor A. Ginsburg and David Throsby, 1:667–719. Elsevier, 2006.

Terviö, Marko. "The Difference That CEOs Make: An Assignment Model Approach." American Economic Review 98, no. 3 (June 2008): 642–68.

Gabaix, Xavier, and Augustin Landier. "Why Has CEO Pay Increased So Much?" The Quarterly Journal of Economics 123, no. 1 (February 1, 2008): 49–100.

Bertrand, Marianne, and Sendhil Mullainathan. "Are CEOs Rewarded for Luck? The Ones Without Principals Are." The Quarterly Journal of Economics 116, no. 3 (August 1, 2001): 901–32.

Neal, Derek, and Sherwin Rosen. "Chapter 7 Theories of the Distribution of Earnings." In Handbook of Income Distribution, 1:379–427. Elsevier, 2000.

Malmendier, Ulrike, and Geoffrey Tate. "Superstar CEOs." The Quarterly Journal of Economics 124, no. 4 (November 1, 2009): 1593–1638.

Piketty, Thomas, and Emmanuel Saez. "Income Inequality in the United States, 1913–1998." The Quarterly Journal of Economics 118, no. 1 (February 1, 2003): 1–41.

Rosen, Sherwin. "Authority, Control, and the Distribution of Earnings." The Bell Journal of Economics 13, no. 2 (1982): 311–23.

Hamlen, William A. "Superstardom in Popular Music: Empirical Evidence." The Review of Economics and Statistics 73, no. 4 (1991): 729–33.

2 Rosen [1983]'s *American Scholar* Piece

During the first course, we start discussing around Rosen [1983]'s *Economics of Superstars* article in *The American Scholar*. This paper has much to it, but Rosen [1983] discusses a number of strong points which we shall come back to. He argues that markets where superstars are important are characterized by a number of common features:

1. Importance of scale

2. Differences in Rewards are incommensurate with Differences in Skills at the top

3.

2.1 Importance of Scale

Rosen [1983] in fact notes that firms are typically not allowed to operate at such large scales (because worries about competition). However, superstars are: "so far as I know, proceedings in restraint of trade were never brought against Caruso, Babe Ruth, Picasso, or the Beatles."

> The first thing to be said in this connection is that certain economic activities admit extreme concentration of both personal reward and market size among a handful of participants. Every economic activity supports considerable diversity of talent and significant inequality in the personal distribution of rewards. Activities where superstars are found differ from those in which most of us make our livings by supporting much less diversity and much more inequality, in the distribution of earnings. The bulk of earnings goes to relatively small numbers of practitioners-typically, the few regarded as among the best in their fields. Similar distributions of earnings in the industrial sector would ultimately come to the attention of the Federal Trade Commission or the Justice Department, but so far as I know, proceedings in restraint of trade were never brought against Caruso, Babe Ruth, Picasso, or the Beatles.

2.2 Δ Rewards >> Δ skills at the top

Rosen [1983] also makes a number of technical points

2.3 Skewness

Overview of what skewness means.

References

Sherwin Rosen. The Economics of Superstars. *The American Scholar*, 52(4):449–460, 1983. ISSN 0003-0937. URL http://www.jstor.org/stable/41210977.