

Clicker quiz: Should the cocaine trade be legalized? (either answer will tell us if you are here or not)

- 1. yes
- 2. no

# Economic Liberalism Summary:

- **Assumptions:** self-interest, rationality, individual freedom of choice, natural private property, spontaneous markets,
- **Hypotheses:** Markets: voluntary exchange → buyers demand goods → sellers produce them → buyers choose rationally (price and quality) → **competition** among sellers → efficiency → Division of Labor
- **Predictions** Freedom, Growth, Welfare, and Peace
- **Policy** Bound by the “rule of law” govt. policies must ensure competition

# Uber is stealing drivers from Lyft: Would Hayek approve?

- A. yes
- B. No
- C. I don't know. I didn't do the reading
- D. I did the reading but still don't know. His writing is obtuse.

# “Big Data”

- Is being used to give Facebook, Google, Amazon, and Apple information about our preferences, where we go, what we do, who our friends are, where our influences come from, what we buy. Does their freedom to use “Big Data” in order to target sales conform to the policies advocated by Economic Liberalism? Would Frieden And Hayek approve?
- A. Yes
- B. No
- C. I’m lost. I don’t know
- D. Yes and No

Would you join a study group for this class?

- A. Yes
- B. No

# Today.....

- We look at two central assumptions of Liberal Economic Theory
  - Individual self interest
  - rationality
- I've argued that assumptions can't be tested, but.....
- There are theories about the validity of those assumptions

# Rational Choice Theory shows that competition is rational

- Theory “tested” by games
- strategic interaction and prisoners dilemma
- Argue that cooperation is best for all but it’s hard to get: the problem of collective action
- Discuss the argument that Institutions and governments are necessary to ensure cooperation---
- Rather than through government, problems of cooperation can be solved through the market mechanism: Coase Theorem

# What Is “Rationality” in rational choice theory?

- the same as in economic liberal theory
  - Individual freedom and equality in ability to act freely
  - Self interest
  - Rationality:
    - shaped by constraints and incentives
      - Costs and benefits
      - the Strategic environment
      - Strategic interaction



# Rationality and Game Theory: When individual rationality can be irrational and competition suboptimal

- Why Game Theory?
  - A Game is a Model of reality:
  - Game:
    1. Players
    2. Strategies:
    3. Payoffs:

# Game of getting what you want : The Stag Hunt-



Cooperation is optimal but rarely achieved: Here is what the calculations look like:

		ME	
		stag	rabbit
YOU	cooperate stag	5 , 5	0 , 3
	Defect rabbit	3 , 0	3 , 3

# That's a second game: the prisoners dilemma



# What would you do?

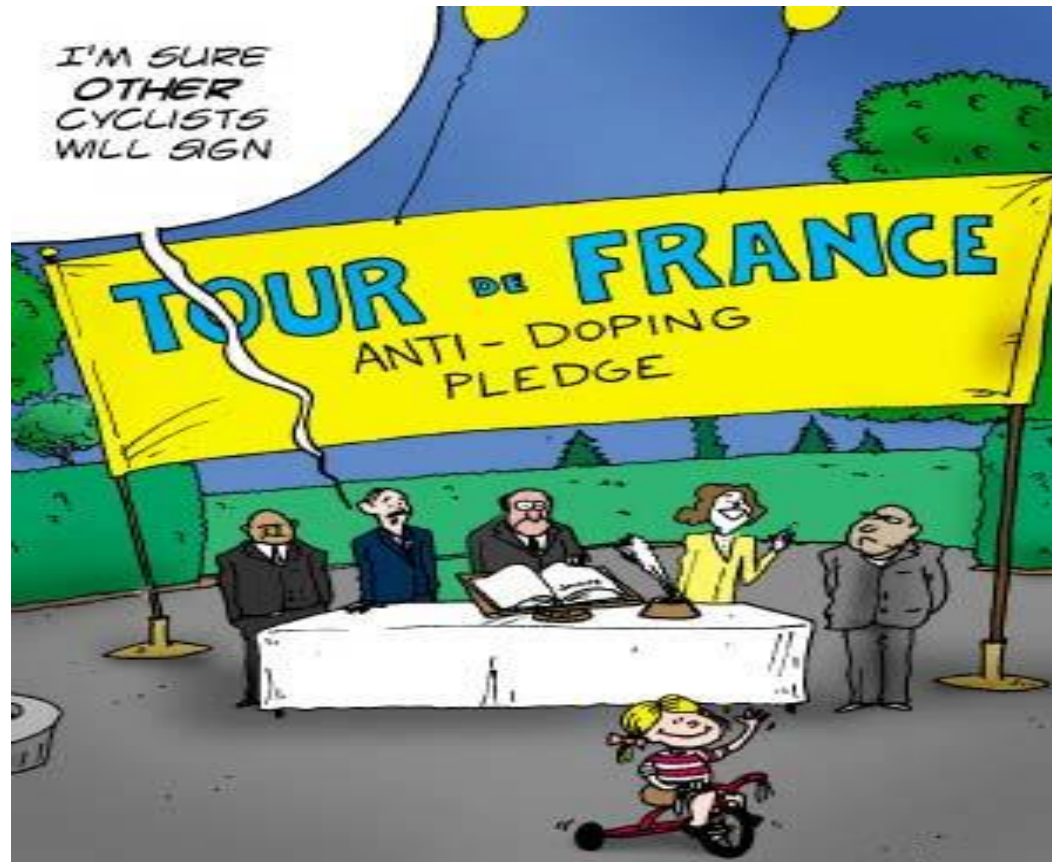
1. Confess
2. Stay silent

# Prisoners Dilemma

**TOM**

		TOM	
		Stay silent <b>Cooperate</b>	confess <b>Defect</b>
<b>T A N Y A</b>	Stay silent <b>Cooperate</b>	Both stay silent, Both get token Sentence (1,1)	Tom goes free Tanya does serious Time (sucker) (5,0)
	confess <b>Defect</b>	Tanya goes free Tom does serious Time (sucker) (0,5)	Both betray each Other and confess Both get early Parole (3,3)

Even WITH information, what is rational for the individual may be irrational for society as a whole



# Why so much doping in cycling?

		Cooperate	Defect
Cooperate	No Doping, low Payoff expected	Column Dopes, Row doesn't, Row is a sucker and loses	
Defect	Row dopes, column doesn't, Row wins, column loses and is a sucker	Everyone dopes, no one Wants to be a sucker, Everyone has high expectations of winning	



# A Higher Authority is needed...

- To impose costs on doping that are higher than the benefits
- Would Friedman and Hayek agree?
- It worked in 2013
- And 2014



Each of us, acting rationally,  
contributes to climate change

Economic Goals seem more rational



# Is the Kyoto Treaty (a higher authority) a vehicle for cooperation?

		Cooperate	Defect
Stay silent	<b>Cooperate</b>	All sign and adhere to the treaty: best for climate	You sign, others Don't... You are A sucker—noone is better off
confess	<b>Defect</b>	You sign, others Don't... You are A sucker noone is better off	All defect everyone is worse off. Worst outcome of all

Would you join a study group for this class?

- A. yes
- B. No

Cooperation is optimal, but how do you get it?

