

Office hours cancelled tomorrow!

Rational Choice and cooperation

Problems of Collective Action and the
Coase Theorem

Today's Menu: 5 points

- Competition (absence of conscious coordination) is an essential feature of markets
 - Good because markets coordinate without cooperation, competition drives efficiency
- Why it's rational **not** to cooperate
- Why it's rational to **not** to cooperate in large groups
- Why cooperation is sometimes better than competition
- How can you get cooperation?
 - Government Authority (political Liberals)
 - Coase Theorem (economic liberals)

competition is an essential feature of markets

- We have been talking about the market system (group of institutions)
- voluntary transactions allocate resources
- Efficiency is achieved
 - Rationality
 - Competition
- This is very convenient for the economic liberal

Why it's “rational” not to cooperate

- Stage Hunt and PD Games explain this
 - Why so much doping in cycling?
 - Why no climate change treaty?
 - Why Arms Races?
 - Why do people always arrive late to parties?

Why so much doping?

THE PRISONER'S DILEMMA

		Column Player		
		Cooperate	Defect	
Row player	Cooperate	R=3, R=3 Reward for mutual cooperation NO DOPING Low Payoff	S=0, T=5 Sucker's payoff and temptation to defect	Column gets High payoff because Row is a sucker and gets nothing
	Defect	T=5, S=0 Temptation to defect and sucker's payoff Row gets High payoff because Column is a sucker	P=1, P=1 Punishment for mutual defection We both dope because At least we get something	



Why do people always arrive late to a party?

	on-time	late
on-time	5 , 5	1 , 3
late	3 , 1	3 , 3

So the “games” show us that:

- cooperation is difficult in general
- But NOT cooperating can be IRRATIONAL!!!!

And especially difficult in Markets because they are large groups—rationality is different in large and small groups

LARGE GROUPS

- the typical participant won't cooperate that much—it's not rational
- No social costs for narrow self-interested behavior
- Large groups trying to cooperate can't act efficiently
- Selfless behavior is not even praiseworthy.

SMALL GROUPS

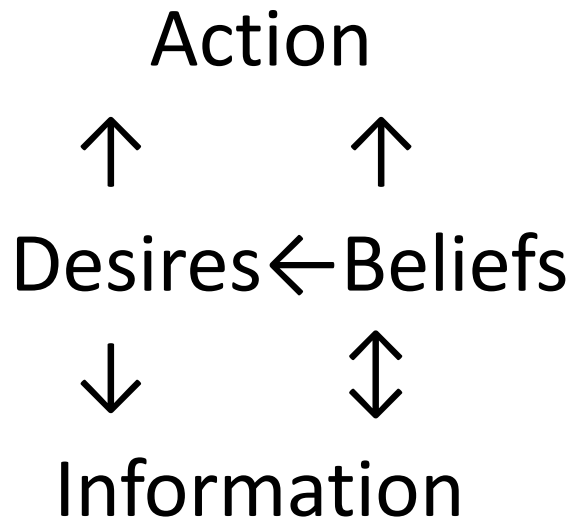
- More social incentives
- Selfless behavior is rational
- Transparency
- Reputation
- Social pressure
- Interaction
- Trust
- consensus

Prisoners Dilemma can be overcome in a small group if communication is possible and interaction long-term

NUCLEAR ARMS RACE

	Cooperate	Defect
Cooperate	US-Russia Communication Transparency Reputation trust	
Defect		IRAN NORTH KOREA

Important role of Information



But Good information is difficult to get in Large Groups

Information is difficult to get in large groups and large groups encourage “free riders”



Rational Actors have no incentive to cooperate in large groups



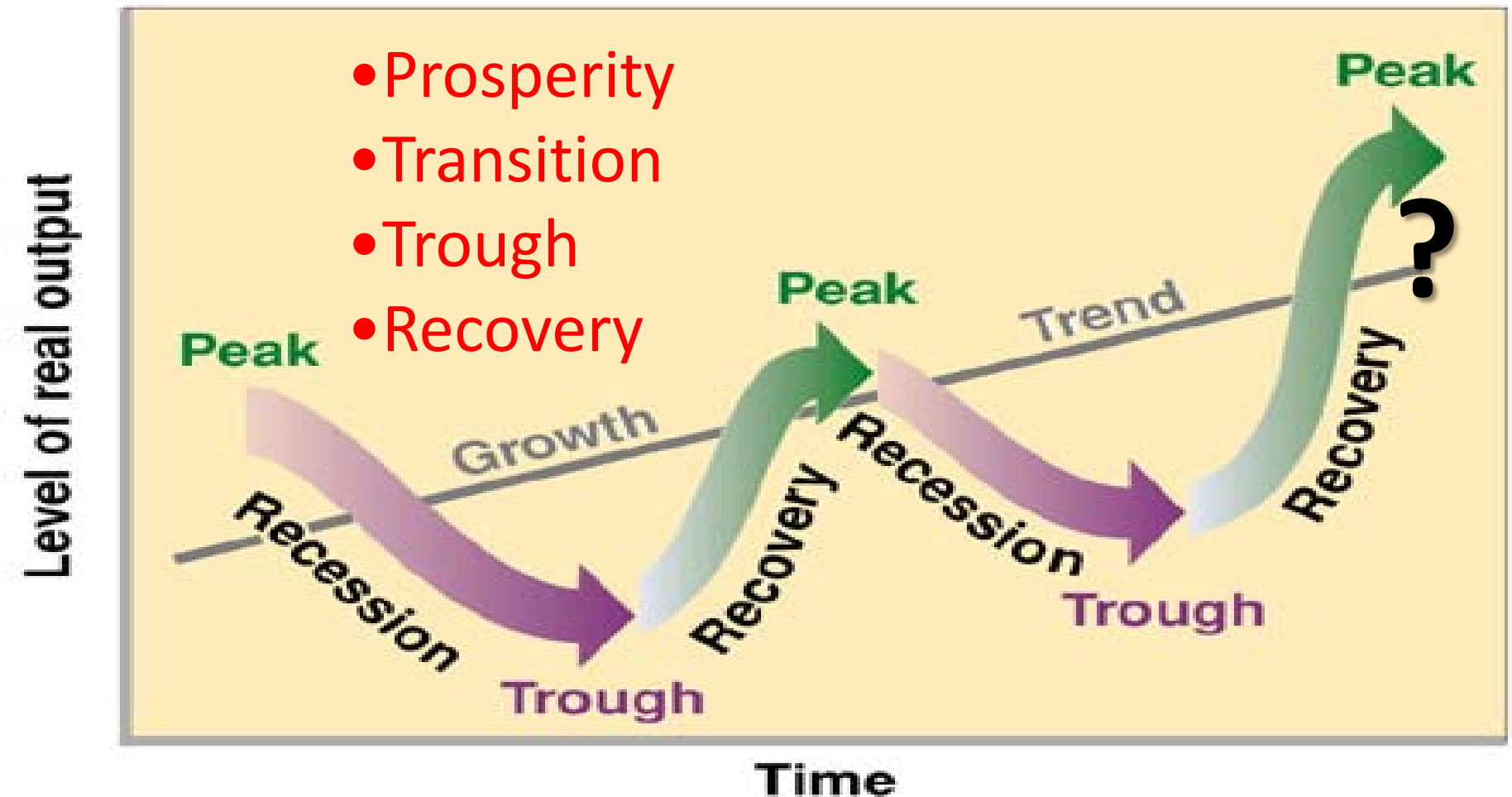
Who Cares anyway?

- Economic liberals believe that “large group” rationality is endemic to human nature;
 - Economic liberals believe that
 - Most incentives encourage narrow, self-interested rationality
 - Our very nature discourages cooperation
- Good because.....
- Markets depend on self-interest and competition to provide the efficiency that produces wealth

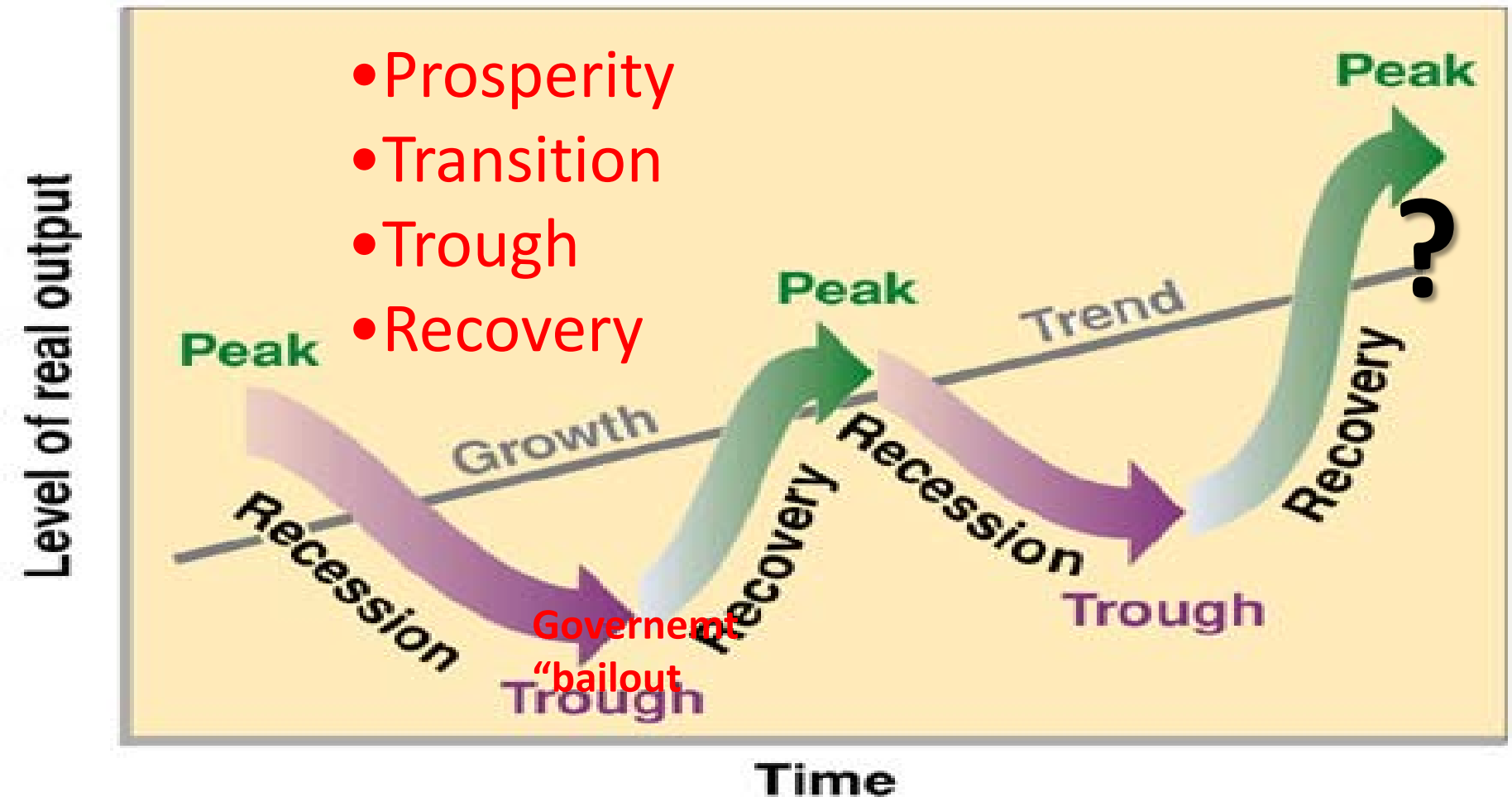
But even economic liberals believe that competition isn't always rational, and institutions (states) can help

- reasons even economic liberals think cooperation might be necessary in a market system :
 - Reduce fraud and cheating
 - Mitigate externalities (neighborhood effects)
 - Create public goods
 - You need cooperation to create Trust.
Why?

Otherwise, just depend on the Business Cycle



Political Liberals don't trust the business cycle. Why not?



Political Liberals believe in government intervention for reasons of stability and justice

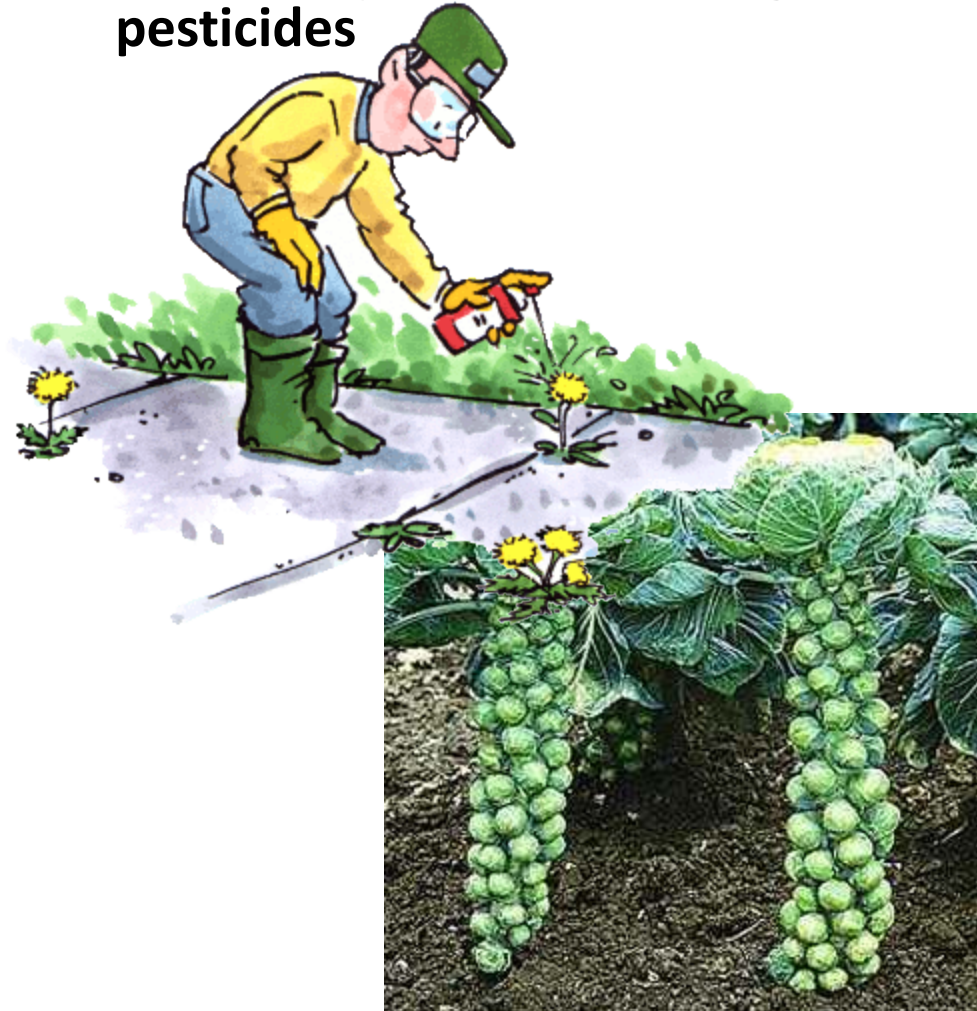
- Political liberals believe that cooperation among citizens creates a more stable environment than competition
- Political Liberals believe that cooperation can be achieved in large groups through the authority of consent

The Libertarian's answer to state coordination: Coase Theorem



Libertarians (economic liberals) say Governments don't have good information and they make mistakes

Brussels Sprouts Farm using pesticides



Herb Farm that wants organic certification



Let's look again at the problem of illegal drugs and try to bring all these things together



What would the Coase theorem say?



Did we show all of this clearly?

- Competition is an essential feature of markets
 - Good because markets coordinate without cooperation
- Why it's rational to compete
- Why it's rational to compete in large groups
- Why cooperation is sometimes better than competition
- How can you get cooperation?
 - Government Authority (political Liberals)
 - Coase Theorem (economic liberals)