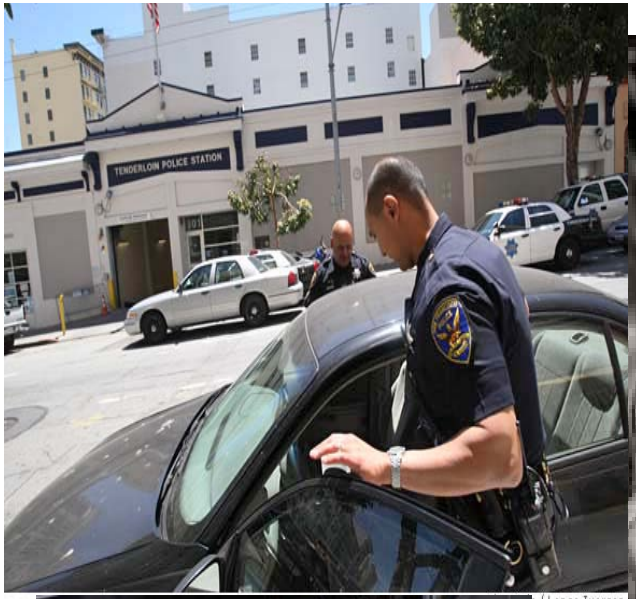
Review http://www.huffingtonpost.com/2011/01/25/obama-state-of-the-union-_1_n_813478.html

- When should the state Take positive action?
  - Intervene in markets when they fail?
  - Regulate in order to minimize externalities?
  - Provide public goods?
  - Provide social safety nets for those who cannot participate in market allocation?
- Liberals are split between those who want the government to protect the market (economic liberals or libertarians) and those who want it to take positive action (political liberals)

The split comes down to preferences for more freedom and efficiency (produces the ultimate social good) vs. more protection of equality and community (individual freedom can produce social “bads”)

Liberal Discontent



Freedom and Rational Choice Theory

Compete or Cooperate?

Today's session we will

- origins of rational choice
- assumptions of rat choice theory
- strategic interaction and prisoners dilemma
- Argue that cooperation is best for all but it's hard to get: the problem of collective action
- Argue that Institutions and governments are necessary to ensure cooperation---ensure competition and more
- Rather than through government, problems of cooperation can be solved through the market mechanism: Coase Theorem

Answers come from building blocks of the liberal economic model!

- Economics seems to be the most successful of the social sciences
  - Assumed that people are motivated by the drive for wealth
- Success led other social scientists to cast an envious eye in its direction
  - They thought: "If we follow the methods of economics, maybe we can achieve similar success!"
- So they began to build theories around the concept that people are rational.

And social scientists came up with rational choice theory

- A Word about Assumptions
- Assumptions the same as in economic liberal theory
  - Free Individuals act in their own self-interest to achieve their goals
  - Individuals make rational calculations to meet their goals
  - Calculations are shaped by constraints and incentives
    - Costs and benefits
    - Strategic environment
    - Strategic interaction

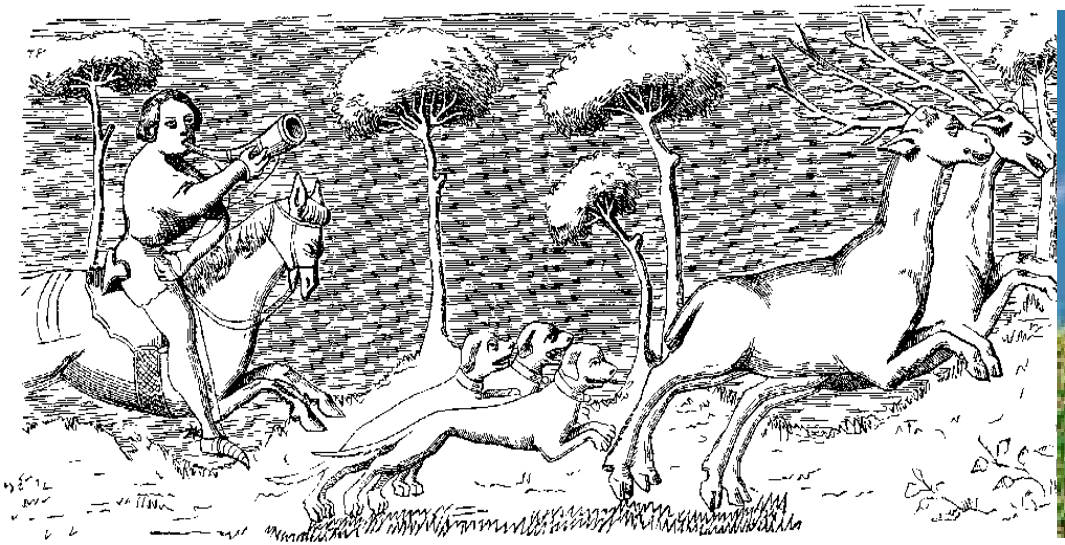
Can we meet our goals through cooperation or competition?

- Can you achieve your goals more rationally by cooperating with others or by striking out on your own?
- We make these calculations all the time…..

Game Theory

- Why Game Theory?
  - A Game is a Model of reality: a simplified version of reality
  - Game: a model of strategic interaction among players. The game has three elements
    1. Players (or actors)
    2. Strategies: plans of actions for all players that set out what player does under all possible contingencies
    3. Payoffs: How our goals are met

Game of getting what you want : The Stag Hunt-



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

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

Should I join a study group or just study on my own?

		Me: join	Me: Study alone
You	join	5 , 5	1 , 3
	Study alone	3 , 1	3 , 3

That’s a second game: Strategic interaction and the prisoners dilemma

Prisoners Dilemma

		TOM	
		Cooperate	**Defect**
TANYA	**Cooperate**	Both stay silent, Both get token Sentence (1,1)	Tom goes free Tanya does serious Time (sucker) (5,0)
TANYA	**Defect**	Tanya goes free Tom does serious Time (sucker) (0,5)	Both betray each Other and confess Both get early Parole (3,3)

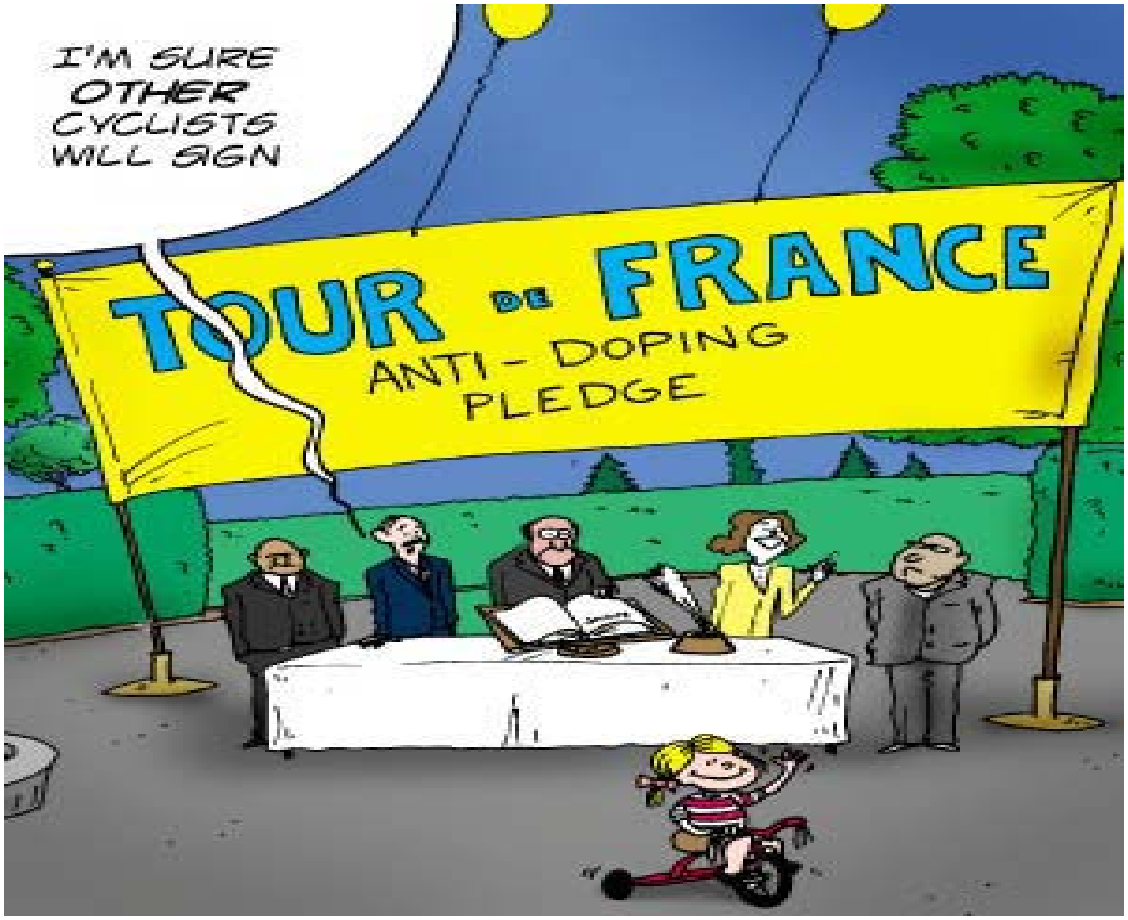
The problem is imperfect information and absence of trust

THE PRISONER'S DILEMMA

Column Player

Row player	Cooperate	Defect
Cooperate	R=3, R=3 Reward for mutual cooperation	S=0, T=5 Sucker's payoff and temptation to defect
Defect	T=5, S=0 Temptation to defect and sucker's payoff	P=1, P=1 Punishment for mutual defection

And imperfect information leads to behavior that causes social costs



Why so much doping?

THE PRISONER'S DILEMMA

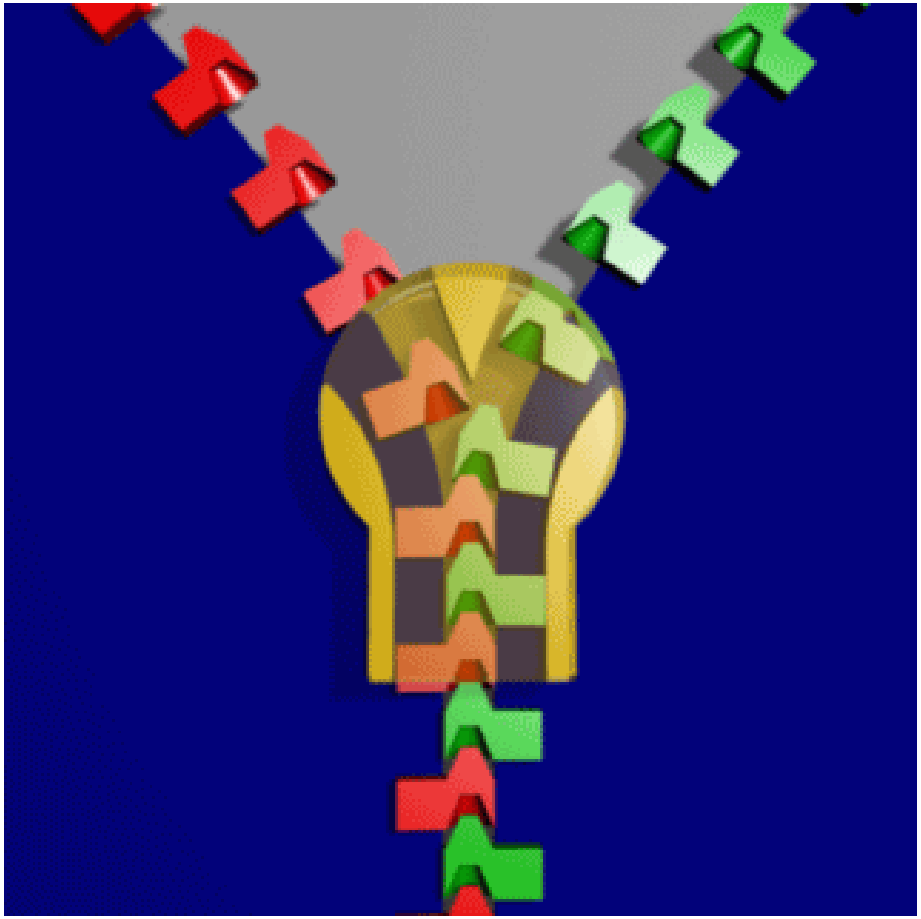
Column Player

Row player	Cooperate	Defect
Cooperate	R=3, R=3 Reward for mutual cooperation **NO DOPING Low Payoff**	S=0, T=5 Sucker's payoff and temptation to defect
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**

Column gets High payoff because Row is a sucker and gets nothing

Each of us, acting rationally, contributes to climate change

Cooperation is optimal, but how do you get it?



You gotta have trust

- hard to move from the low-trust situation, to the more trusting situation.
- You try to achieve what you want on your own because risk that others will defect.
- But trust lowers your perception of risk

The End