Principles of Economics
Moral Philosophy
Essential Principles

J. Bradford DeLong
U.C. Berkeley
A Set of Principles for Analyzing Market Economies

• Krugman and Wells:
  – Principles of individual decision-making
  – Principles of social interactions
  – Principles of macroeconomics
A Set of Principles for Analyzing Market Economies II

- Krugman and Wells:
  - Principles of individual decision-making
  - Principles of social interactions
  - Principles of macroeconomics

- I would add:
  - Where do markets come from?
A Set of Principles for Analyzing Market Economies III

• Krugman and Wells:
  – Principles of individual decision-making
  – Principles of social interactions
  – Principles of macroeconomics

• I would add:
  – Where do markets come from?
  – What do markets get us?
A Set of Principles for Analyzing Market Economies IV

• Krugman and Wells:
  – Principles of individual decision-making
  – Principles of social interactions
  – Principles of macroeconomics

• I would add:
  – Where do markets come from?
  – What do markets get us?
  – What do we lose from markets?
Essentials of Economics: Individual Decision Making

- Principles of individual decision-making:
  - People must make choices because resources are scarce
    - What if resources aren’t scarce? We’ll focus our attention on an area of life in which they are scarce!
Principles of individual decision-making:
- People must make choices because resources are scarce
  - What if resources aren’t scarce? We’ll focus our attention on an area of life in which they are scarce!
- The opportunity cost of an item is its true cost
Essentials of Economics: Individual Decision Making III

• Principles of individual decision-making:
  – People must make choices because resources are scarce
    • What if resources aren’t scarce? We’ll focus our attention on an area of life in which they are scarce!
  – The opportunity cost of an item is its true cost
  – “How much” decisions inevitably involve making decisions at the margin
• Principles of individual decision-making:
  – People must make choices because resources are scarce
    • What if resources aren’t scarce? We’ll focus our attention on an area of life in which they are scarce!
  – The opportunity cost of an item is its *true* cost
  – “How much” decisions inevitably involve making decisions *at the margin*
  – People *usually* respond to *material* incentives—exploiting opportunities to make themselves better off
    • “man has almost constant occasion for the help of his brethren, and it is in vain for him to expect it from their benevolence only”
Essentials of Economics: Principles of Social Interaction

- Principles of social interactions:
  - There are gains from trade
    - “In civilized society [man] stands at all times in need of the cooperation and assistance of great multitudes”
    - “[Man’s] whole life is scarce sufficient to gain the friendship of a few persons”
    - “A spaniel endeavours by a thousand attractions to engage the attention of its master…. [Man] has not time, however, to do this upon every occasion”
Essentials of Economics: Principles of Social Interaction II

• Principles of social interactions:
  – There are gains from trade
    • “In civilized society [man] stands at all times in need of the cooperation and assistance of great multitudes”
    • “[Man’s] whole life is scarce sufficient to gain the friendship of a few persons”
    • “A spaniel endeavours by a thousand attractions to engage the attention of its master…. [Man] has not time, however, to do this upon every occasion”
  – Resources ought to be used as “efficiently” as possible
Principles of social interactions:
- There are gains from trade
  - “In civilized society [man] stands at all times in need of the cooperation and assistance of great multitudes”
  - “[Man’s] whole life is scarce sufficient to gain the friendship of a few persons”
  - “A spaniel endeavours by a thousand attractions to engage the attention of its master…. [Man] has not time, however, to do this upon every occasion”
- Resources ought to be used as “efficiently” as possible
- Markets move toward “equilibrium”
Essentials of Economics: Principles of Social Interaction IV

- Principles of social interactions:
  - There are gains from trade
    - “In civilized society [man] stands at all times in need of the cooperation and assistance of great multitudes”
    - “[Man’s] whole life is scarce sufficient to gain the friendship of a few persons”
    - “A spaniel endeavours by a thousand attractions to engage the attention of its master…. [Man] has not time, however, to do this upon every occasion”
  - Resources ought to be used as “efficiently” as possible
  - Markets move toward “equilibrium”
  - Market equilibrium usually (?) leads to efficiency
Essentials of Economics: Principles of Social Interaction V

• Principles of social interactions:
  – There are gains from trade
    • “In civilized society [man] stands at all times in need of the cooperation and assistance of great multitudes”
    • “[Man’s] whole life is scarce sufficient to gain the friendship of a few persons”
    • “A spaniel endeavours by a thousand attractions to engage the attention of its master…. [Man] has not time, however, to do this upon every occasion”
  – Resources ought to be used as “efficiently” as possible
  – Markets move toward “equilibrium”
  – Market equilibrium usually (?) leads to efficiency
  – When markets don’t achieve efficiency, government intervention can improve society’s welfare
Principles of macroeconomics:
- One person’s spending is another person’s income
- Overall spending sometimes gets out of line with the economy’s productive capacity
- Government policies can change spending
Essentials of Economics: Macroeconomics II

• Principles of macroeconomics:
  – One person’s spending is another person’s income
  – Overall spending sometimes gets out of line with the economy’s productive capacity
  – Government policies can change spending

• But we won’t talk about these until after spring break.
  – For the next two months we will assume that people in aggregate want to spend their incomes today
  – Those who want to spend less than their income are balanced by those who want to spend more
Governments Create Markets

- Money and trust
  - “Thick-tie” exchanges
  - “Thin-tie” exchanges
  - Weights and measures
- Property rights
- Contract enforcement
- Threats to property, contract, and (arms-length) exchange:
  - Positive and negative affective ties
  - Roving bandits
  - Local notables
  - Government’s own functionaries
Governments Distort Markets

• Markets do very important jobs
  • How much should be traded
  • Who should buy
  • Who should sell
• Governments follow alternative logics
  • Logic of politics
  • Logic of bureaucracy
  • Logic of favoritism
  • Logic of corruption
  • Logic of logrolling
  • Logic of insurance
  • Logic of redistribution
Governments Complete Markets

- Non-excludibility
  - Extend property rights
- Non-rivalry
  - Public provision of public goods
- Unknown quality
  - Quality control, mandated participation, “pooling” equilibria
- External effects
  - Taxes and subsidies
- Miscalculations
  - Nudges
- Distribution
  - Redistribution and social insurance