

Week 2: Trade and Property Rights

- I. Selfishness and Cooperation
 - A. Many people assume that selfish people are uncooperative people.
 - B. But this is hardly a clear matter. A selfish person will eagerly cooperate with another person so long as cooperation is more personally beneficial than conflict.
 - C. Ex: We are alone on an island. If I'm selfish, will I necessarily steal from you?
 - D. When you think about this more critically, a great deal of supposedly unselfish behavior becomes easier to interpret in terms of self-interest.
 - 1. Friendship
 - 2. Politeness
 - E. This doesn't mean that there is no unselfish component, but that the difference between the way the current world looks and the way it would look if everyone were completely selfish is not so great.
- II. Trade As Mutual Benefit
 - A. If I gain from cooperating with you, it is in my selfish interest to do so. But doesn't this imply that it WON'T be in your selfish interest to cooperate with me?
 - B. This question assumes we are playing what is called a "zero-sum game," such as a race.
 - C. Zero-sum games are however quite rare. Much more often, there are positive-sum games - where the total gain of cooperation exceeds the total gain of conflict.
 - 1. Yes, there are also negative-sum games, like war.
 - D. In positive-sum games, selfish agents naturally tend to TRADE to realize these benefits.
 - E. The whole idea of trade is that I have B, you have A, I prefer A to B, and you prefer B to A. Then if I give you B in exchange for A, we are both better off!
 - F. Innumerable examples:
 - 1. Buying lunch.
 - 2. Buying a house.
 - 3. Selling labor.
 - 4. Buying insurance.
 - 5. Getting married.
 - G. Simple statement: When selfish agents trade, all of the traders expect to be better off; otherwise they wouldn't have agreed to the bargain.
- III. Comparative Advantage

- A. It's easy to see how trade works if two people have different strengths.
 - 1. Ex: Trading Antarctic ice for tropical fruit
- B. But what if one side is better across the board? What's the point of trading then?
- C. Surprisingly, mutually advantageous trade is still totally possible.
- D. Intuitively: Suppose the world's best brain surgeon is also the world's fastest typist. Should he still hire a secretary?
- E. Numerical example: Suppose that in a day, American and Mexican women can produce:

	American Woman	Mexican Woman
Computer Programs Written	4	.1
Children Cared For	2	2

- F. Both sides can increase production by immigration and specialization! Have ten Mexican women switch from writing computer programs to childcare (-1 program, +20 childcares), and one American woman switch from childcare to computer programs (+4 programs, -2 childcares). The world is richer by 3 programs and 18 childcares.
- IV. Exploitation Fallacies: Better-Off Versus Well-Off
- A. All this seems obvious, but a great deal of intellectual energy has been devoted to denying it. The most common version is to label trade as "exploitation" of one party by another.
 - B. Ex: I hire you to mine coal for \$1/day.
 - C. Ex: I charge you \$10,000 for a glass of water in the desert.
 - D. Isn't this "exploitation"?
 - E. Fallacy of exploitation is inference from "Bryan is not doing well after this trade" to "Bryan is not better off as a result of this trade."
 - F. After I trade \$10,000 for a glass of water, my position is still unpleasant. But am I better off for having a glass of water more and \$10,000 less? Of course.
 - G. The charge of "exploitation" makes more sense if you first CAUSE my problem, and then trade with me to get rid of it! Ex: Slavery.
 - H. But if I would have had my problem whether you existed or not, your offer to trade with me can't make me worse off.
 - I. Suppose I work for you for \$1/day. Why should I blame you? You are offering me more than anyone else! If I should blame anyone, it is all of the other people who won't outbid you.
 - J. Ex: Low-paid workers shouldn't blame foreign investors; if anyone, they should blame foreigners who *don't* invest in their country.
 - K. Numerous other examples where this charge of exploitation surfaces:
 - 1. Foreign "dumping"
 - 2. Slumlords
 - 3. Used pacemaker (*Law and Order*)
 - 4. Unapproved drugs

- 5. Narcotics
 - 6. Prostitution
- V. Paternalism and Trade
 - A. A quite different argument from the "exploitation" one is the **paternalistic** argument that *people are mistaken about their own interests*.
 - B. Key idea: Put the blame on the folly of the "loser," rather than the greed of the "winner."
 - C. Unlike the exploitation argument, the paternalistic argument is at least coherent.
 - D. Some economists define this problem away, which doesn't strike me as very plausible.
 - E. Other replies:
 - 1. Individuals normally know their own interests best; often it is the "do-gooder" who is the fool. Individuals may just be making the best of a bad situation.
 - 2. People are extremely diverse, that doesn't make them idiots.
 - F. Replies to replies:
 - 1. We are all foolish some of the time; we need to protect our "smart" selves from our "dumb" selves.
 - 2. Other people have to pay for the bad risks people assume.
 - G. On balance, I don't see much force to paternalistic arguments most of the time, but it is a caveat to keep in mind for future reference.
- VI. Trade and Reciprocal Altruism
 - A. How much "trade" is really going on? Probably more than you realize. Much of what appears to be simple unselfishness or altruism is actually "reciprocal altruism" - trade in disguise.
 - B. Origin in biology: One chimp grooms another, then they reverse roles. Or vampire bats share extra blood.
 - C. With humans, there are many areas where people are trading favors over time.
 - 1. Family
 - 2. Work
 - 3. Friends
 - D. Key test: If you stopped responding, would the other person still keep giving favors to you?
 - E. Thus, the analysis of trade has a broader application than it first appears.
- VII. Trade as Technology
 - A. The Iowa car crop
 - B. Alone on an island, Crusoe has many technologies for producing wealth.
 - C. Key lesson: Trade is just an *additional* technology from Crusoe's point of view. The fact that it involves other people (like Friday) is actually *irrelevant* from the point of view of a selfish actor!

- D. From a purely selfish point of view, people who refuse to trade are just hurting themselves. (Of course, they are hurting potential trading partners as well...)

VIII. Property Rights

- A. All of this talk of trade implicitly supposes that the traders have "property rights" - that they are trading things that are theirs to dispose of to begin with.
- B. Like trade, people often think of property in terms of "exploitation."
- C. Economists' standard reply:
- D. Respecting property rights provides the incentive for people to:
 - 1. Produce more things
 - 2. Maintain things they do have
- E. In other words, without property rights, the property probably wouldn't have existed in the first place. (The physical matter of course would exist in any case, but its usefulness to people is another thing altogether!)
- F. The case of unsettled land: what incentives do property rights in land create here?

IX. Profit-Maximization

- A. There is a crucial distinction between **accounting profits** and **economic profits**! Economic profits count opportunity cost of capital and labor; accounting profits don't.
- B. The accounting approach eliminates a lot of judgment calls, but it's classic "Looking for your keys under the streetlight because it's brighter there." Who cares if your home business made an accounting profit of \$100,000, if you ignore the fact that you could have made \$200,000 by working for someone else? Who cares if you made a 3% accounting profit on your investment, if you could have made 6% in the stock market?
- C. In this class, "profit" means "economic profit" unless stated otherwise.
- D. Most businesses try to make money, and the more that businesses prioritize making money, the more likely they are to survive and expand.
- E. Result: Businesses tend to "*maximize* profits." They're trying to make the difference between total revenue and total cost as large as possible.
- F. Doesn't this lead businesses to charge sky-high prices? Not necessarily. Maybe they make more money by selling high quantities at low prices.
- G. Doesn't this lead businesses to cut corners? Not necessarily. Maybe they make more money by selling high quality products for high prices.
- H. The essence of profit-maximization: being all of the following at the same time:
 - 1. Cost-conscious

- 2. Consumer-conscious
 - 3. Risk-conscious
- I. A lot of SDB attacks all three aspects, but on reflection they are highly socially functional.
- X. The Tragedy of the Commons
 - A. It is *possible* for something to be unowned. This has frequently happened. For example, a pasture may be "common property." Oceans are normally unowned, accessible to all.
 - B. Frequently, however, common ownership gives rise to what economists call the "tragedy of the commons." Since no one owns it, people use it without regard to the effect on others.
 - C. And, once you realize that people think this way, you also have an incentive to take as much as possible NOW, because the resource won't be useful very long. This can "snowball" into an awful outcome that benefits no one.
 - D. Key idea: If one person owned the fisheries, or a forest, or a pasture, they would have the incentive to maintain it, improve it, and take a long-term perspective.
 - E. That is the benefit of property rights that is absent in the commons - a benefit not just for owners, but for users as well.