LECTURE 4

8 August 2024

- When self-interest works and when it doesn’t
- **Public goods** and the problem of **free riding**
- **Conflicts of interest** and **bargaining**
- Application: The global climate change problem

Economic tools:

- **Game theory**: players, strategies, payoffs
- Predicting outcomes: **Nash equilibria**
- Analyising preferences through **behavioural experiments**

Social Dilemmas

Social dilemma

Social dilemma = a situation in which actions taken independently by self-interested individuals result in a socially suboptimal outcome e.g. traffic jams, climate change.

One of the tasks of public policies is to address social dilemmas

The tragedy of the commons

- Cattle herders each raise ever-larger herds, eventually overgrazing their pastureland.
- **Common-pool resources** = resources that are shared, not owned by anyone
- Resources of this are easily overexploited unless we control access in some way
- **Free riding** = Benefiting from the contributions of others to some cooperative project without contributing oneself

Resolving social dilemmas: preferences & policies

1. **Social preferences:** A person with these preferences cares about the implications for other people.
2. **Public policies** in the form of quotas and taxes
3. Local communities can create their own **institutions** to regulate behaviour

Self-interest and Economic Outcomes

Game theory: Key concepts

- **Social interaction:** A situation in which the actions taken by each person affect other people's outcomes as well as their own.
- **Strategic interaction:** A social interaction in which the participants are aware of the ways that their actions affect others (and the ways that the actions of others affect them).
- **Strategy:** An action (or a course of action) that a person may take when that person is aware of the mutual dependence of the results for herself and for others.