

## Economists' views on Moral and Policy issues

### Remember Last Week

- Moral choices (laws, policies) involve trade-offs.
- ...and therefore disappointment.
- Hence, we need the optimum am't of good things (not maximum).
- 'How much' not 'which kind.'
- Proportionality.
- Making most of our resources (welfare).

### Opportunity Costs

- Everything is a substitute for something else.
- Prices – and experience of trade-offs – teach us this.
- No absolute, objective or intrinsic values (when allocating resources).

### Marginalism

- Produce x until next input can be used more productively to produce y.
- Consume x until the next one will produce less satisfaction than y.
- Rational decision making is 'marginalist.'
- Related to substitutability, opportunity costs, subjectivity of value.

### Another related concept: Law of Diminishing Returns (DR)

- Marginal product falls as tot. investment rises
- Marginal satisfaction falls as tot. consumption rises.

### Why marginal returns (eventually, normally) decline.

- For consumers:
  - Second vacation less valuable than first.
- For producers
  - Sell apples until next buyer is indifferent between apples and oranges.
  - First added worker boosts marginal returns, subsequent added workers less so.
  - Benefits of complementarity vs. costs of crowding.
  - Many workers, 'who's doing what?', incomplete contracts.

### Why economists say it's rational to be marginalist.

- What's valuable here isn't valuable there.
- Value (of same thing) changes from  $t^1$  to  $t^2$ .
- Water in a desert, umbrella on a rainy day.
- Difficulty of long-term planning, 'once and for all' decisions.

### Why DR matters for social policy.

- Best to flexibly adjust to DR through 'incremental substitution'.

- Markets ‘force’ producers to do this.
- We treat health care and education as ‘categorical priorities’. (Sowell)
- Should we hire more nurses and doctors?
- Gov’t vs. Market.

#### Market Mechanism – Invisible hand

- No need for centralized, pre-planned decisions.
- Willingness to pay is measure of value.
- Only need individual self interest.
  - Consumers want lowest price.
  - Producers want most profit.
- Even slime-bags forced to think about welfare of others.

Don’t trade & markets reward the wrong activities?: “the middleman”

Do these market intermediaries create value, add to social welfare?

- Banks and moneylenders.
- Convenience stores.
- Wal-Mart.
- Energy traders (Enron?).
- Cable companies.

#### Economists’ defense of brokers

- Against ‘physical fallacy’: good’s value *can* be changed simply by relocation.
- No ‘just price’.
- Banks: making money from money?
- Real Estate agents.
- Why Wal-Mart is good (well, somewhat).
- Payday lenders.

#### Solutions to middleman problems

- Regulating the payday loan industry.
- Cable companies: forced to lease bandwidth.
- Bank defaults: credit ratings rather than repossession.