

# Humans in the economy

Vladan Hodulak

This powerpoint serves as a study material for the students of the course Introduction to economics (MEB435) at FSS MU in Fall 2018. Using this presentation for other purposes without consent of the author is prohibited.

# Economics

- Political economy
  - Adam Smith: „branch of the science of a statesman or legislator.“
  - J. S. Mill: “a science that teaches a nation how to become rich.“
- Contemporary mainstream economics
  - Discipline redefined after „marginalist revolution“
  - Neoclassical economics and its variants (conservative × neo-Keynesian)
  - L. Robbins (1932): „Economics is the science which studies **human behavior** as a relationship between **ends** and **scarce** means which have **alternative uses**.“
  - A science about human decision-making under the conditions scarcity
  - Rational individuals, utility maximizers, market analysis, supply and demand, equilibrium

# Return of political economy?

- Alternative schools of economics
  - Marxian economics
  - (post)Keynesian economics
  - Austrian economics
  - Institutional economics
- Economics as the study of social creation and social distribution of society's resources.
- Political science and international relations
  - is the study of the ways in which political power is acquired and used in a country (among countries)
- Development of political economy and the question of power

# Levels of analysis problem

- Neoclassical economics – focus on the individual
- IR – focus on politically organized groups
- Levels of analysis
  - International system × state
  - State × bureaucracy
  - Bureaucracy × individual
- Agency × structure problem: is human behavior influenced by social structure? How and to what extent?
  - This question is irrelevant for neoclassical economics
  - But is obviously very important if one wants to intervene in the real world

# Mankiw „Principles of economics“

- The most popular economics textbook
- Microeconomics × macroeconomics
- How people make decisions
  - People face tradeoffs (scarcity)
  - The cost of something is what you give up to get it (opportunity costs)
  - Rational people think at the margin (marginalism)
  - People respond to incentives (prices, competition)

# Mankiw „Principles of economics“

- How people interact
  - Trade can make everyone better off (specialization, division of labor)
  - Markets are usually a good way to organize economic activity (invisible hand)
  - Governments can sometimes improve market outcomes (market failure, public goods, externality)
- How the economy as a whole works
  - A country's standard of living depends on its ability to produce goods and services (productivity)
  - Prices rise when the government prints too much money (inflation)
  - Society faces a short-run trade-off between inflation and unemployment (business cycle)

# People and the Economy

- Humans are the most important actor in social sciences – we need a theory of human economic behavior on the individual (micro) level
- Fundamentals of human economic decision making
  - Preferences
  - Constraints
  - Beliefs
- Origin of preferences and beliefs
  - Genes
  - Culture
- Conscious decision-making × habits

# Neoclassical economics

- Most important actor: rational individual, self-interested behavior (utility maximizers) -> **homo economicus**
- Preferences and beliefs
  - exogenous
  - Humans are „complete“ before their enter into relationships with others
- Influence of the society (culture, economic and political system) is unimportant or considered exogenous
- Economics concerns itself with decision-making of rational actors under the conditions of scarcity (constrains, resources)



# Behavioral experiments

- Information provided by field studies and behavioral experiments is often contrary to the assumptions of neoclassical economics
- Taking decisions on the margin × Haifa experiment
- Ultimatum game
- Profit sharing and the importance of norms
- People as well as societies differ from each other in very important ways but nowhere is homo economicus even close to being a typical representative of the society
- Probable explanation
  - Relative influence of genes and culture
  - Preferences and beliefs are endogenous
- Economic reproduction
- The scale of cooperation among humans is unique

# Economic coordination

- Economic system – a way of organizing the human labor needed in every society to produce the goods and services that support life (and distribution of those goods and services)
- Three dimensional economics
  - Competition
  - Command
  - Change
- Neoclassical economics and the three dimensions
  - Homo economicus
  - Complete contracting assumption
  - Irrelevance of increasing returns to scale