

# The Microeconomics of Competition, Coordination, Cooperation and Conflict

Economics 700

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*Objective:* to provide an introduction to fundamental microeconomic concepts relevant to the generic problem of coordinating social interactions among autonomous actors, with particular attention to conflict, competition, collective action, and coordination failures in capitalist economies, and the process of innovation and change in individual preferences and social structures.

*Prerequisites:* admission to the doctoral program in economics and economics 751 (may be taken concurrently), or permission of the instructor. Students from doctoral programs in resource economics, management, and the other social sciences, and other fields having adequate mathematics background are welcome. Except in unusual circumstances I do not welcome auditors.

*Course requirements:* fortnightly problem sets, two in class exams, and participation in class discussions of the readings (except in unusual circumstances late submissions of work will not be considered.)

*Readings:* The numbered sections are (roughly) topics for class meetings. Many of the readings will be from Samuel Bowles, *Economic Institutions and Behavior: An Evolutionary Approach to Microeconomics* (EI & B), which may be downloaded from my webpage. An asterisk \* indicates optional, while o indicates a reading which I expect you to be ready to discuss at the meeting indicated. Knowledge of the material in Herbert Gintis= *Game Theory Evolving* is not presumed in the course, but you will find this a helpful source of theory and applications concerning strategic interaction. Additional readings on most of these topics are found in the reading list for the seminar Theoretical Institutional Economics, on my webpage.

*Coordinates:* You may contact me by email at bowles@econs.umass.edu (I will respond within 24 hours to questions about course material, copying your post and my response to the entire class (unless you ask me not to).) I also arrange office hours by email. If you are curious about my own research interests check my webpage: <http://www-oit.umass.edu/~bowles>.

## Course Outline and Readings

### 1 Introduction: Old Problems, New Insights

1.1 Introduction: What Economics is (Really) About (Getting the Rules Right)

1.2 Post Walrasian Economics: Increasing returns, incomplete contracts, and non-standard preferences.

o Joseph Stiglitz, *Whither Socialism?* Chapter 1 ("The Theory of Socialism and the Power of Economic Ideas") \*1-6, 6-14.

o Brian Arthur, "Positive feedbacks in the economy," *Scientific American*, (February, 1990) 92-99. (You may want to read \*Brian Arthur's more extensive "Competing Technologies, Increasing Returns, and Lock-in by Historical Events," *Economic Journal*, 99(March 1989):116-131.)

o Ernst Fehr and Simon Gächter, "Fairness and Retaliation: the economics of reciprocity," forthcoming in *J.Econ.Perspectives*.

o Samuel Bowles and Herbert Gintis, "Walrasian Economics in Retrospect" *Quarterly J. of Economics*, November, 2000.

\* Samuel Bowles and Herbert Gintis, "The Revenge of Homo Economicus: Contested Exchange and the Revival of Political Economy," *J. Economic Perspectives*, Winter, 7,1(Winter,1993):83-102. (You may want to look, also, at the following responses to this essay on the pages immediately following: \* Oliver Williamson, "Contested Exchange Versus the Governance of Contractual Relations" and \* Joseph Stiglitz, "Post Walrasian and Post Marxian Economics.")

\* Thomas Schelling, "Sorting and Mixing: Race and Income" in Schelling, *Micromotives and Macrobehavior*, (NY, Norton, 1979):\*137-147, 147-166.

\* Steven Durlauf, "The Membership Theory of Inequality: Theory and Evidence" unpublished, 1997.

### 2 Social Structure and Individual Action

## 2.1 Social interactions as games

o EI & B, Chapter 1, *Social Interactions and Institutional Design*

\* Herbert Gintis, *Game Theory Evolving*, (Chapters 1-5).

\* Eric Rasmusen, *Games and Information*, ch. 1 ("The Rules of the Game"), 9-29.

\* David Kreps, *Game Theory and Economic Modelling*, ch 3 ("Basic Notions of Non-cooperative Game Theory") 10-36 (\*chapters 4-6: a useful account of the successes and limit of game theory).

\* Jon Elster, *The Cement of Society*, Introduction, 1-16.

## 2.2 Spontaneous order and the evolution of behaviors

o EI & B Chapter 3 *Spontaneous Order and the Evolution of Behavior*

\* Robert Sugden, "Spontaneous Order," *J.Econ. Perspectives*, 3,4, (1989) 85-97.

\* H.Gintis, *Game Theory Evolving*, chapter 7.

\* John Maynard Smith, *Evolution and the Theory of Games*, 10-23 ("The Hawk Dove Game" and "A Review of Assumptions")

\* David Lewis, *Convention*, ch 1 ("Coordination and Convention") 1-51.

## 2.3 Preferences and Behavior

o EI & B, Chapter 2, *Preferences and Behavior*

\* Elinor Ostrom, "A Behavioral Approach to ..Collective Action," *Am.Pol.Sci.Rev.*, 92,1(March, 1998):1-16.

\* Samuel Bowles, "Endogenous Preferences: The Cultural Consequences of Markets and Other Economic Institutions," *J. Economic Literature*, March 1998

\* Gary Becker, "Preferences and Values," in Becker, *Accounting for Tastes* (1996):3-23.

\* Albert Hirschmann, "Against Parsimony: Three Easy Ways of Complicating Some Categories of Economic Discourse," *Economics and Philosophy*, 1(1985), 7-21.

\* H. Gintis, "Consumer Behavior and the Concept of Sovereignty: Explanations of Social

Decay," *American Economic Review*, 62:2 (May, 1972) 267-278.

- \* George Stigler and Gary Becker, "De Gustibus Non Est Disputandum" *American Economic Review*, 67(1977):76-90.
- \* Cass Sunstein, "Endogenous Preferences, Environmental Law," *J. Legal Studies*, XXII(June, 1993):217-254.
- \* Amartya Sen, "Rational Fools: A Critique of the Behavioral Foundations of Economic Theory," *Philosophy and Public Affairs*, 6:317-344.
- \* John Roemer, "Rational Choice Marxism: some issues of substance and method," in Roemer, ed., *Analytical Marxism*, 191-201.
- \* Daniel Kahneman, "New Challenges to the Rationality Assumption," *J. Institutional and Theoretical Econ.* 150,1(1994):18-36.
- \* Gary Becker, "Irrational Behavior and Economic Theory," *Journal of Political Economy*, LXX,1(February,1962), 1-13.
- \* Adam Przeworski, "Marxism and Rational Choice," *Politics and Society*, 14,4(1985), 379-409.
- \* Robert Lane, *The Market Experience*, chapter 26 ("Buying happiness") 524-547.
- \* Daniel Kahneman, Jack Knetsch, and Richard Thaler, "Fairness and the Assumptions of Economics," *Journal of Business*, 59,4(1986):S285-S300.
- \* Daniel Kahneman, Jack Knetsch, and Richard Thaler, "Experimental Tests of the Endowment Effect and the Coase Theorem," *J.Pol.Econ*, 98,6(December 1990):1325-1348.
- \* Linnda Caporeal, et. al., "Selfishness Examined: Cooperation in the Absence of Egoistic Incentives," *Behavioral and Brain Sciences* (1989), 12, 683-697.

## 2.4 Coordination Failures and Institutional Responses

- o G. Hardin, "The Tragedy of the Commons," *Science*, 162 (Dec, 1968), 1343-8
- o EI & B, Chapter 4, *Coordination Failures and Institutional Responses*
- \* Elinor Ostrom, *Governing the Commons*, ch 1 ("Reflections on the Commons") 1-28.

- \* Michael Taylor, *The Possibility of Cooperation*, ch 1 ("The Problem of Collective Action"), 1-13, 18-33.
- \* Sara Singleton and Michael Taylor, "Common Property, Collective Action, and Community," *Journal of Theoretical Politics*, 4(3):309-324(1992).
- \* F.Berkes, et al, "The Benefits of the Commons," *Nature*, 340(1989):91-93 (on how communities solve commons problems)
- \* Jon Elster, *The Cement of Society*, ch 1 ("Coordination Problems") 17-50.
- \* David Kreps, *A Course in Microeconomic Theory*, 148-156 ("Social Choice and Efficiency") (This is a review of basic concepts.)

## 2.5 Coordination failures and institutional responses (continued)

## 2.6 Bargaining, Fighting, and Sharing

- o EI & B, Chapter 5, *Dividing the Gains to Cooperation*
- \* Herbert Gintis, *Game Theory Evolving*, chapter 15.
- \* Eric Rasmusen, *Games and Information*, 275-284.
- \* Leif Johansen, "The Bargaining Society and the Inefficiency of Bargaining," *Kyklos*, 32,3(1979):497-522.
- \* Jon Elster, *The Cement of Society*, ch 2 ("Bargaining") 50-96.
- \* Russell Hardin, *Collective Action*.
- \* Robert Sugden, *The Economics of Rights, Cooperation and Welfare*.

## 2.7 Exam

# 3 Contracts, Markets, and Organizations

## 3.1 Decentralized Coordination

- o Kenneth Arrow, "Political and Economic Evaluation of Social Effects and Externalities," in M.D. Intriligator, ed., *Frontiers of Quantitative Economics*, 3-23.
- o Robert Cooter "The Coase Theorem," John Eatwell, et. al., eds., *The New Palgrave*,

457-459.

- o Joseph Farrell "Information and the Coase Theorem," *J.Econ. Perspectives*, 1:2 (Fall, 1987) 113-122, 124-126.
- o EI & B, Chapter 6, *Decentralized Coordination*
- \* Harold Demsetz, "The Exchange and Enforcement of Property Rights," *J. Law and Economics*, 7(1964), 11-26.
- \* Ronald Coase, "The Problem of Social Cost" *J. Law and Econ.*, 1(1960) 1-44.
- \* Francis Bator, "The Simple Analytics of Welfare Maximization," *AER* 47 (March, 1957) 22-59.
- \* Cass Sunstein, *After the Rights Revolution*, 47-73 ("The Functions of Regulatory Statutes.")
- \* Paul Milgrom and John Roberts, *Economic Organization and Management*, 62-71 ("The Fundamental Theorem of Welfare Economics")

### 3.2 Markets, Contracts and Organizations

- o EI & B, Chapter 7, *Markets, Contracts, and Organizations*
- \* Kenneth Arrow, "The Economics of Agency," in Pratt and Zeckhauser, *Principals and Agents*, 37-51.
- \* Joseph Stiglitz, "The Causes and Consequences of the Dependence of Quality on Price," *J.Economic Literature*, XXV (March, 1987):1-48.

### 3.3 The Governance of Exchanges with Transaction Specific Assets

- o Oliver Hart, "An economists perspective on the theory of the firm," *Columbia Law Review*, 89:1748(1989):1757-1774.
- o R. Coase, "The Nature of the Firm," *Economica*, ns 4 (1937), 386-405.
- \* Oliver Williamson, "The Economics of Governance," *J. Institutional and Theoretical Economics*, 140(1984) 195-209.
- \* Ugo Pagano, "Property Rights Equilibria and Institutional Stability," in *Economic Notes*, 20,2(1991):189-228.

- \* David Kreps, "Corporate Culture and economic theory" in James Alt and Kenneth Shepsle, *Perspectives on Positive Political Economy*, 90-132.

### 3.4 Firms and Labor Markets as Social Institutions

- o EI & B, Chapter 8, *Firms and Labor Markets as Social Institutions*
- \* Armen Alchian and Harold Demsetz, "Production, Information Costs, and Economic Organization," in *AER* (December, 1972), 777-795.
- \* S. Bowles and H. Gintis, "Contested Exchange: New Microfoundations for the Political Economy of Capitalism," *Politics and Society*, 18,2 (June, 1990) 165-222.

### 3.5 Firms (continued)

### 3.6 Credit Markets

- o EI&B, Chapter 9, *Credit Markets*
- o Karla Hoff, "Market Failures and the Distribution of Wealth: A Perspective from the Economics of Information," *Politics and Society*, December, 24,4 (Dec 1996) 411-432.
- \* Pranab Bardhan, Samuel Bowles, and Herbert Gintis, "Wealth Inequalities, Wealth Constraints, and Economic Performance," in A. Atkinson and F. Bourguignon, *Handbook of Income Distribution*, forthcoming.

### 3.7 Equilibrium Contracts

- o Mukesh Eswaran and Ashok Kotwal, "Credit and Agrarian Class Structure, in Bardhan, *The Economic Theory of Agrarian Institutions*, 166-184.
- \* John Roemer, "New directions in the Marxian theory of exploitation and class," in John Roemer, ed., *Analytical Marxism*, 81-113.

### 3.8 The economic institutions of capitalism.

- o EI & B, Chapter 10, *The Economic Institutions of Capitalism*
- \* Albert Hirschmann, *Exit, Loyalty, and Voice*, ch 1 ("Introduction and Doctrinal Background") 1-5; 15-20.
- \* R.H.Coase, "The Institutional Structure of Production," (Nobel Lecture, 1991), *AER*

82,4(September 91):713-719.

\* Oliver Hart, *Firms, Contracts and Financial Structure*.

\* Oliver Williamson, *The economic institutions of capitalism*.

## 4 The Evolution of Economic Institutions and Behavior

### 4.1 Economic Evolution: Dynamic Analysis

o EI&B, Chapter 11, *Institutional Change*

o Peyton Young, "Conventions" *J.Econ Perspectives* 10(1995):105-122.

\* Gintis, *Game Theory Evolving*, chapters 9-11.

\* Armen Alchian, "Uncertainty, Evolution, and Economic Theory," *J. Political Economy*, 58(1950):211-221.

### 4.2 Collective Action and Institutional Change

o EI & B, Chapter 12, *Collective action and institutional innovation*.

### 4.3 Social Structure and the Evolution of Human Sociality

o EI&B, Chapter 13, *Groups, Conflict, and the Evolution of Pro Social Norms*

\* Robert Boyd and Peter Richerson, "Culture and Cooperation" in Jane Mansbridge, ed., *Beyond Self Interest*, 111-127

\* Elliott Sober and David Sloan Wilson, "Human Groups as Adaptive Units" in *Unto Others: the evolution and psychology of unselfish behavior*, (Cambridge: Harvard, 1998):159-194.

\* Samuel Bowles and Herbert Gintis, "The evolution of strong reciprocity," Santa Fe Institute Discussion Paper, December, 1998.

\* J. Elster, "Social Norms and Economic Theory," *J. Econ. Perspectives*, 3,4, (1989) 99-117.

\* Robert Axelrod and William Hamilton, "The Evolution of Cooperation," *Science*, 211 (27 March, 1998) 1390-1396.

- \* Elliott Sober, "What is Evolutionary Altruism?" *Canadian J. of Philosophy*, s14, 75-99.
- \* Samuel Bowles and Herbert Gintis, "The Moral Economy of Communities: Structured Populations and the Evolution of Pro-social Norms," *Evolution and Human Behavior*, November, 1997.
- \* Herbert Simon, "A Mechanism for Social Selection and Successful Altruism," *Science*, 250, (21 December, 1990):1665-1668.
- \* Frans de Waal, *Good Natured: the origins of right and wrong in humans and other animals*. (Cambridge, Harvard, 1996.)

#### 4.4 The Coevolution of Institutions and Preferences

- o EI & B, Chapter 14, *The Co-evolution of Institutions and Preferences*

### 5 Reprise: Getting the Rules Right Redux

- o EI&B, Chapter 15. *Economic Governance: Markets States and Communities*.
- \* Joseph Stiglitz, "Rational Peasants, Efficient Institutions, and a Theory of Rural Organization," in Pranab Bardhan, *The Economic Theory of Agrarian Institutions*, 18-29.
- \* F. A. Hayek, "The Use of Knowledge in Society" *American Economic Review*, 35,4, (September, 1945), 519-530
- \* Michael Taylor, "Good Government: On Hierarchy, Social Capital, and the Limitations of Rational Choice Theory," in *J. Political Philosophy*, 4,1(March,1996):1-25.
- \* William Ouchi, "Markets, Bureaucracies, and Clans," *Administrative Sciences Quarterly*, 25 (March, 1980) 128-141.
- \* S. Bowles "What Markets Can - and Cannot - Do," *Challenge*, July August, 1991, 11-16.
- \* Samuel Bowles and Herbert Gintis, "Reciprocity, Self Interest and the Welfare State" *Nordic J. Econ.*, 2000,1(January) (appears in slightly different form as *Altruism and equality* in *Boston Review*, with reactions by critics, December, 1998.)
- \* Herbert Simon, "Organization and Markets," *J. Econ.Perspectives*, 5:2(Spring, 1991):25-44.

- \* Pranab Bardhan, "Alternative Approaches to the Theory of Institutions in Economic Development" in Bardhan, ed., *The Economic Theory of Agrarian Institutions*, 3-17
- \* Jack Knight, *Institutions and Social Conflict*, ch 2 ("The Primary Importance of Distributional Conflict") 21-47.