

# **IMPERFECT INFORMATION IN A STUDENT'S LEARNING OF ECONOMICS**

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## All 4 of us teach foundation courses in economics

We are all aware that the content of the text books that we prescribe – and hence the content we deliver – have flaws and gaps

So, are we as instructors agents of moral hazard?

If we deliberately push the line of certain text books (and/or ideas) – then are we not guilty of asymmetric information?

We choose 3 issues/topics

- **Microeconomic foundations of macroeconomics**
- **Premises for rational behaviour and basic axioms**
- **Perfect competition and sustainability**

Some of our critics say that these can be covered in later year courses – BUT a good number of students might get exposure to economics only through foundation courses –

Even for students who will continue with economics – it is difficult to unlearn the content of foundations courses

# Microeconomic Foundations of Macroeconomics

The symmetry between the markets in equilibrium and the overall macroeconomic equilibrium ( $GDP \equiv Y$ )

GDP is sum of product market expenditures; Y is sum of factor market expenditures

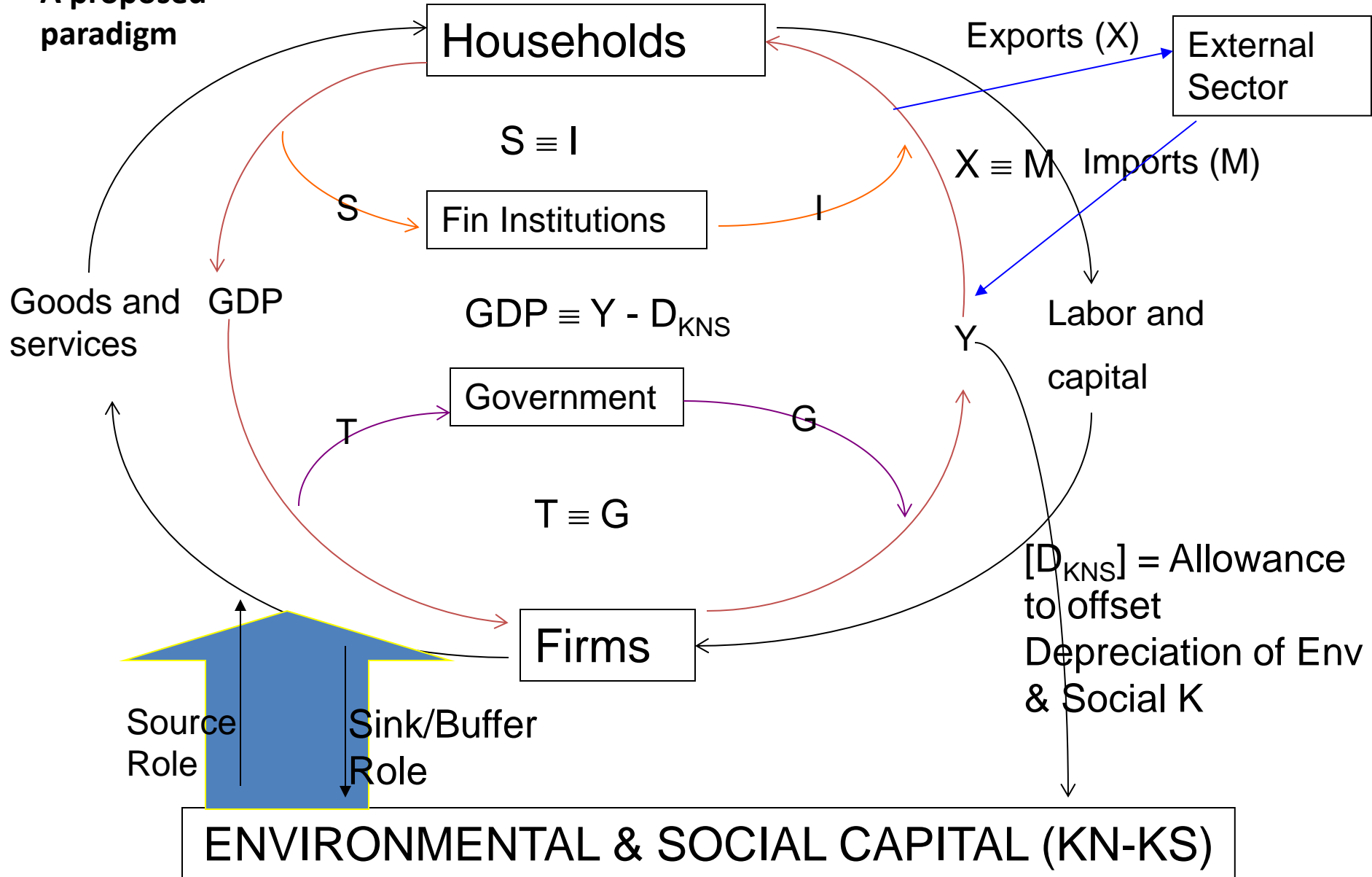
Environmental degradation is exclusively within the domain of microeconomics and is accommodated through internalization of externalities – So GDP and Y would be revised accordingly

**BUT externalities are never fully internalized. RESIDUAL EXTERNALITIES EXIST AND THEY ACCUMULATE**

So the revised equilibrium needs to be: ( $GDP' \equiv Y - D_{KN}$ ), where  $D_{KN}$  represents a measure of the residual externality that remains

Do we not introduce the principles of environmental social accounting? Almost all text books and leading authors don't

A proposed paradigm



KN-KS is the foundation stone that supports the economic system by providing it with basic resources and also acting as a buffer to withstand the fallouts that emerge from the economic system

# Premises and Axioms

Individuals and firms are driven by:

- Self-interest
- Present gain

This translates to wanting to maximize utility or profits and preferring these for “**now**” rather than “**later**”

Such behaviour is labelled RATIONAL

Behavioural Economists challenge these premises

The rationality extends to axiomatic differentiation between “**Goods**” and “**Bads**”

**Goods:** *Prefer more to less*

**Bads:** *Prefer less to more*

But this axiomatic differentiation deters sustainability

# Economics 101: Perfect Competition

- Anonymity
- Homogeneity
- Perfect mobility
- Perfect information
- Full employment

Basic Result:

**Market equilibrium configurations that maximize net benefits –**



Bigger the market bigger the net social benefit

This validates the underlying axiom for the distinction between “a **Good**” and “a **Bad**”, which is:

“**Good**”: *More* is preferred to *less*

“**Bad**”: *Less* is preferred to *more*

# Changes in Basic Axioms

Now add **sustainability** to the conditions of perfect competition, that is, markets must exist indefinitely

Revised Result:

**Market equilibrium configurations that maximize net benefits over an infinite time period**

The underlying axiom for the distinction between “a **Good**” and “a **Bad**” could change

- “**Good**”: *Less* is preferred to *More*
- “**Bad**”: *More* is preferred to *Less*

If we had this understanding – some of the following statements (in the next slide) would be definitely strange

**Mankiw** (2004, 2009):

“Although natural resources can be important, they are not necessary for an economy to be highly productive in producing goods and services. Japan, for instance, is one of the richest countries in the world, despite having few natural resources....”.

(Japan is in fact exporting environmental damage)

**Lawrence Summers** (as chief economist of World Bank – December 1991)

“I think the economic logic behind dumping a load of toxic waste in the lowest-wage country is impeccable and we should face up to that.” .....“I’ve always thought that **under-populated countries in Africa are vastly under polluted.**”

Can we say that these Harvard professors are propagating moral hazard or information asymmetry?