

The Skeptical Economist:

A Proposal for a Microeconomics Class for Undergraduate or Masters Students

By David K. Levine

We see ragged and wretched refugees fleeing not war in Syria but economic policy in Venezuela. Although you would be hard pressed to find an economist of any political leaning who did not predict this would be the consequence of the economic policies introduced by Hugo Chavez you will find political leaders who are convinced both that Hugo Chavez was a great man and that economists are always wrong. Not that economists are always right: there are Nobel Prize winning economists telling political leaders that the solution to their problem is to “end austerity.” That means: borrowing money to spend more – not practical unless someone is willing to lend you money. And if an economist tells you that a country should default on debt – do you know that the first thing to check is the “primary deficit?”

Politicians, economists, multi-national firms, NGOs, lobbying groups, and governments contend over a variety of economic issues. They are mediated by three letter international organizations such as the IMF, WTO and the IPO. All have agendas and employ a motley array of economists and consultants – who have their own agendas. Modern economics not only sheds light on who is right and who is wrong – but helps us understand who will succeed and who will fail.

If you need to hire or consult with economic experts or to read and understand economic research and summarize those results in a non-technical way then you must be able to identify people and research that employ appropriate knowledge and technique. You must screen the wheat from the chaff; make independent judgments about the validity of research conducted by experts. In a word: you must tell the difference between experts and charlatans. You must understand what economics can and cannot do. You must understand economics not as it is imagined by pundits but as it is done today by economists.

To succeed requires basic skills in economic theory and statistics – the ability not only to separate good research from bad, but the ability to form intuition and do back of the envelope calculations that make it possible to say – to a consultant for example – “Okay, that makes sense” or “That seems completely crazy, you better have some good explanation of how you came to that conclusion.”

Class Outline

1. (review) A math refresher course for those who have not recently studied calculus
 - a. differential calculus
 - b. optimization theory
 - c. monopoly power, transfer payments and dead-weight losses.
2. Risk and uncertainty
 - a. what axiomatic theory is really about
 - b. basic probability theory including expected values and Bayes law; applications to such phenomena as drug testing
 - c. expected utility, risk aversion, and basic dynamic programming

- d. the Allais, Ellsberg and Rabin paradoxes and the equity premium puzzle
- 3. Behavioral economics
 - a. irrationality, prospect theory, framing effects, nudging
 - b. procrastination, present bias
 - c. incomplete learning
 - d. altruism and social preferences
 - e. which behavioral forces have proved important in practice? experimental methods, selection and scientific fraud
- 4. Game theory
 - a. normal and extensive form games
 - b. dominant strategies, mixed strategies and randomization, Nash equilibrium and perfection
 - c. auctions, transnational procurement, coordination games, Sherlock Holmes, political contests, warfare, externalities and public goods, the Prisoner's Dilemma, coordination and conflict in transnational economic policy
 - d. why rational individuals do not imply rational outcomes and why more ethical people may make the world a worse place.
 - e. learning: when do we expect to see equilibrium? rational expectations and the uncertainty principle for the social sciences.
- 5. Time and dynamics
 - a. discounting and present value
 - b. repeated games including the repeated prisoner's dilemma
- 6. Mechanism design
 - a. auctions and market design
 - b. transnational procurement and standard setting
- 7. Markets and competition
 - a. the controversy over market clearing and Keynesian economics
 - b. experimental markets
 - c. consumer surplus, tax incidence, the problem of monopoly
 - d. the meaning and significance of the core for trade policy
 - e. the big three failures: coordination, externalities, and insurance
- 8. Policy mistakes versus policy blunders