ECOS3003: Final Notes
Lecture 1/Week 1: Intro

1.1 Markets, organisations and the role of the market

1.1.1 The market
- Market mechanism: determines economic activity where activity within the firm is centrally planned
- Pareto efficiency: no alternative allocation that keeps all individuals as well of but makes at last one person better off
  - Large economy outcome better than central planning

1.1.3 Property rights
- Right to select uses of economic good, private property right assigned to specific person & alienable as transferred to another person
  - Use rights (renting through a contract)
  - Alienable rights (landlord sell apartment but can use whilst being leased – become veto rights to give a firm bargaining power)

1.1.5 Externalities
- As market prices reflect costs, externalities prevent markets from being efficient (to max social surplus, SMB = SMC)
- Coarse theorem: ultimate resource allocation is efficient regardless of initial assignment of property rights as long as contracting costs low and PR clearly defined, enforced, exchanged readily
  - Gains from trade not distribution rights affect distribution of income (final outcome)
  - Assume no transaction costs (search, info, bargaining, decision, enforcement costs)
  - Prevent outcome if benefits smaller with greater no. of parties (need to deal with parties before they arrive)
  - Coarse theorem alternative: merge entity to account for externality and maximise surplus

1.1.6 Market and central planning
- Market vs. central planning (bureaucracy/firm)
  - Market advantage: price system motivates better use of knowledge (decentralised system of organising production) & stronger incentive for individual to make productive decision
  - Need to know your value of a product and the production price – market price transfers all info
- *General vs. specific knowledge*
  - General: free to transfer vs. specific: expensive to transfer (cost of communication, knowledge idiosyncratic, scientific or assembled) – ensures effective allocation
  - Central planned: difficult to incorporate specific K in DM (aggregate specific & costly to transfer)
  - Market economy: decisions decentralised to individuals, likely to have relevant knowledge – if they have property rights & specific knowledge then reap rewards otherwise trade assets
- Incentives in markets
  - Private property rights give owners incentive to act on specific knowledge for benefit
  - Central planners limited incentives to make productive use of info as don't own resource

1.1.7 Contracting cost & existence of firms
- Coarse: economic transaction involve costs (contracting, info, policy enforcement)
  - Optimal – economic transaction to minimise contracting costs, otherwise OC if transaction results in inefficient resource allocation
  - *Use firm: transaction cost of organising production cost inside firm < market – make input*
  - *Does not set up expectations but assumes best opportunity will occur*
- Transactions: N+M if firm sells to N customers, hires M factors of production vs. NxM if each customer contracts with each factor
- Contracting cost in firm: as firm gets large, organising economic activity in firm increases, managers harder to make effective decisions (lack specific knowledge), monitor workers