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Economics in Two Lessons

By: John Quiggin

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John Quiggin is a passionate advocate of the application of economics to inform public policy towards the goal of improving the human condition. He has developed a deep appreciation of the workings of the market mechanism over several decades of experience as a researcher, policy advisor and public commentator dealing with policy issues of the day. *Economics in Two Lessons* is his practical guide for the non-economist to understanding when markets can be expected to work on their own and when they need direct or indirect intervention from governments.

Quiggin provides minimalist summaries of the two lessons in the Introduction. 'Lesson One: Market prices reflect and determine opportunity costs faced by producers and consumers.' 'Lesson Two: Market prices don't reflect all the opportunity costs we face as a society.' The difference between private and social opportunity costs is the primary focus of the book, but Quiggin delves much deeper while explaining the pluses and minuses of markets.

Lesson One, delivered in the first three chapters, is basic free-market economics. Under conditions of unfettered competition, the pursuit of self-interest by individuals and firms determines equilibrium prices that equal the private opportunity costs to both consumers and producers. The emphasis is on how well markets solve the complex problems of coordination in highly interdependent modern economies. Along the way, Quiggin flags qualifications for further attention in Lesson Two, especially with regards to market power, incomplete information and deviations between private and social opportunity cost.

The second three chapters discuss applications of Lesson One. Chapter 4 illustrates how market work, with examples from airlines setting fares, students choosing to pursue degrees and viewers watching "free" TV. Chapter 5 applies Lesson One to economic policy, reaching the conclusion that, 'trying to make public policy by regulating prices or allocating scarce resources and services by fiat rarely works well', with examples of price controls and restrictions on the form and use of foreign aid. There is also discussion of the importance of property rights for ensuring owners take account of the full opportunity costs of their actions, with examples of fishing rights and rights to use portions of the telecommunications spectrum. Chapter 6 applies the opportunity cost concept to analysing the destructive impact of natural disasters and war.

Lesson Two takes up twice as many pages as Lesson One. There are five chapters (Chapters 7 through 11) outlining situations where markets often fail to deliver in the best interests of society and another five (Chapters 12 through 16) discussing implications of these failures for public policy. Rather than reflecting the author's bias, the allocation of pages reflects the complexities of modern economies compared to the simple idealised world of Lesson One.

Chapter 7 uses the theory of welfare economics to identify a key difference between Lesson One and Lesson Two. Lesson One takes the existing pattern of property rights as predetermined, whereas Lesson Two starts by noting that any of an infinite array of allocations of property rights can be consistent with market equilibrium. With unfettered competition and market equilibrium, prices are such that self-interested consumers and firms choose levels of economic activity resulting in a Pareto-optimal allocation of resources. However, governments play a key role in the definition and enforcement of property rights, thereby having profound impact on market outcomes and on the resulting distribution of income. According to Quiggin, Lesson One does nothing to guide the choice of one allocation of property rights over another.

Most of the discussion of failures of the market in Lesson Two concerns divergences between opportunity costs to society and the private opportunity costs faced by individuals and firms. Chapter 8 is devoted to unemployment, pointing out that the social opportunity cost of idle resources is zero even though the market price remains positive. Chapter 9 deals with market failures due to monopoly, where the market price of product is above the producer's opportunity cost. The market failures discussed in Chapter 10 are due to externalities that lead to costs or benefits accruing to members of society beyond those directly involved in production or consumption activities. Finally, Chapter 11 discusses market failures where production and consumption decisions are based on incomplete or erroneous calculations due to imperfect information or uncertainty.

Chapters 12 through 16 deal with the implications of Lesson Two for public policy. Chapters 12 and 13 deal with policy affecting income distribution, with the former chapter devoted to predistribution, covering the impact of property rights allocation, and the latter dealing with redistribution through tax and expenditure policy. The discussion in these two chapters is more much extensive and perceptive than that found in introductory economics texts. The reader is regaled with the myriad ways in which government actions influence the distribution of income, with many of those actions leading to increased inequality.

Chapter 14 through 16 deal with public policy towards unemployment, monopoly and the environment, respectively. The pluses and minuses of different forms of government intervention are discussed in each case. For unemployment the position is strongly put that governments can and should intervene to minimise unemployment. For monopoly arising from unavoidable economies of scale or for public goods, a case is made for government ownership. Finally, for dealing with environmental pollution and climate change, direct controls, taxes and tradable permits all get a positive mention.

Overall, Quiggin's preferred policy prescription for dealing with inequality, unemployment and other forms of market failure is government intervention. However, he acknowledges the undue influence of special interests in the political process. He also mentions problems of implementation, including difficulties of accurately measuring social opportunity costs and delays in government action.

If ever there was a time for a thorough, thoughtful and accessible treatment of the role of government in the modern mixed economy, that time is now. Transmission of the coronavirus that leads to Covid-19 is an externality with widespread and life-threatening consequences. In response, governments of all persuasions have intervened in their economies in unprecedented ways. The need for interventions to deal with the immediate threat will pass, but the need for action to rebuild damaged economies and provide resilience against future threats will remain.

I highly recommend *Economics in Two Lessons* for trained economists and non-economists alike. The former will be reminded of the easily forgotten nuances of their trade, while the latter will gain an enlightened exposure to both the science and art of economics. A great virtue of the book is the use of up-to-date examples to provide an intuitive explanation of how modern economies function. There are also excellent suggestions for further reading at the end of each chapter. John Quiggin draws on his immense experience in public policy analysis to bring the dismal science to life.

When it comes time to acquire your copy of *Economics in Two Lessons* you will have a choice of sources. You might be able to acquire a copy from a local bookshop (assuming it has a very large or esoteric selection), you can order direct from the publisher, Princeton University Press, you can utilise the convenience of Amazon.com or you might be able to obtain a pirated electronic copy.

Unfortunately, Quiggin's two lessons don't give sufficient guidance to ensure your choice of source for acquiring the book is in the best interests of society. The positive externalities associated with local bookshops or speciality academic publishers don't reduce your opportunity cost as reflected in the purchase price. Also, each source is likely to generate different royalties for the creator of the intellectual property, John Quiggin. Perhaps, Lesson Three needs to examine ways in which collective interests can be better incorporated into the market behaviour of individuals. A highly interdependent society with a mixed economy needs such behaviour if it is to be resilient to weaknesses of both the unregulated market and government interventions directed by a political system driven by special interests and limited by the constraints of bureaucracy. As with any progressive discipline, there are always more economic lessons to be learned.