¶ 1.1

What Is a Free Market?

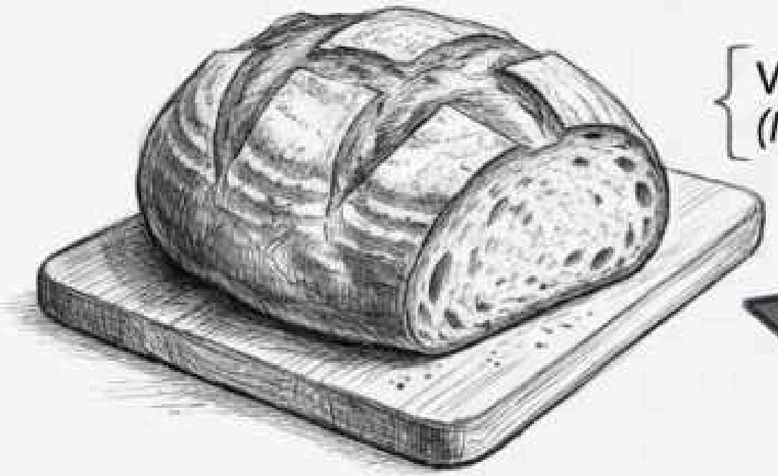
ECON 110 B – Lecture 1

Welcome to Lecture 1.



¶ 1.2

VOLUNTARY EXCHANGE & SPONTANEOUS ORDER



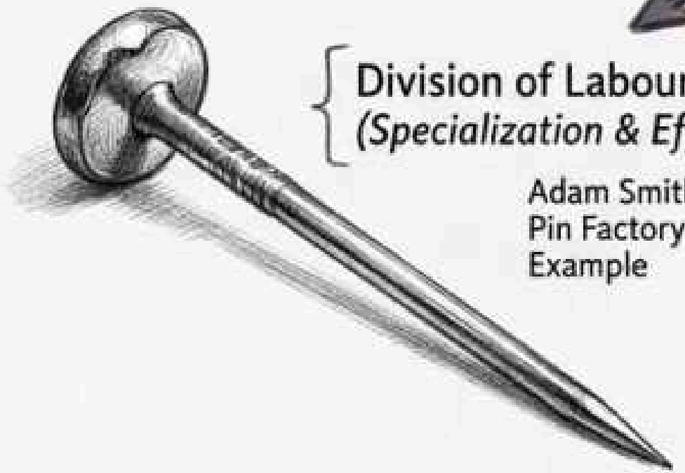
Voluntary Exchange
(Mutual Benefit through Trade)

Foundational Principle

I, Pencil & Spontaneous Order
(Decentralized Coordination)



Read's Essay on Complex Cooperation

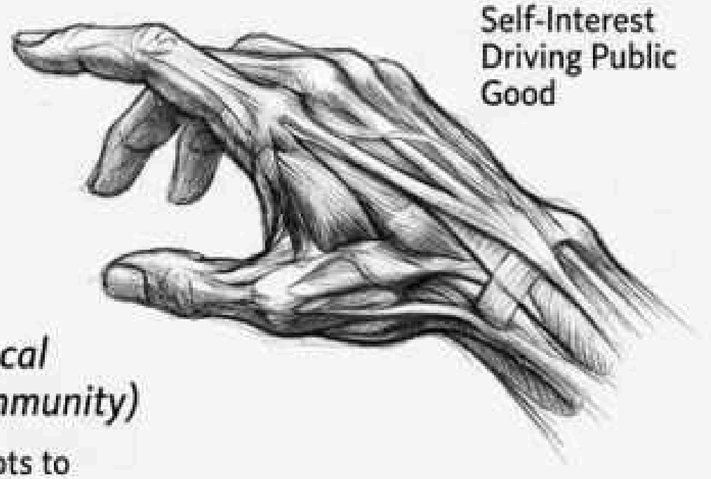


Division of Labour
(Specialization & Efficiency)

Adam Smith's Pin Factory Example

The Invisible Hand
(Unintended Social Benefits)

Self-Interest Driving Public Good





Millbrook
(Case Study: Local Economy & Community)

Applying Concepts to a Micro-Level System

¶ 1.3







$V_{Rosa} = \$5$ (Value to Rosa) $C_{Pavel} = \$2$ (Cost to Pavel) $P = \$3$ (Agreed Price)

Rosa's Surplus: $\$5 - \$3 = \$2$ Pavel's Surplus: $\$3 - \$2 = \$1$

$\sum$ Gain = $3 (Net gain, no force required)

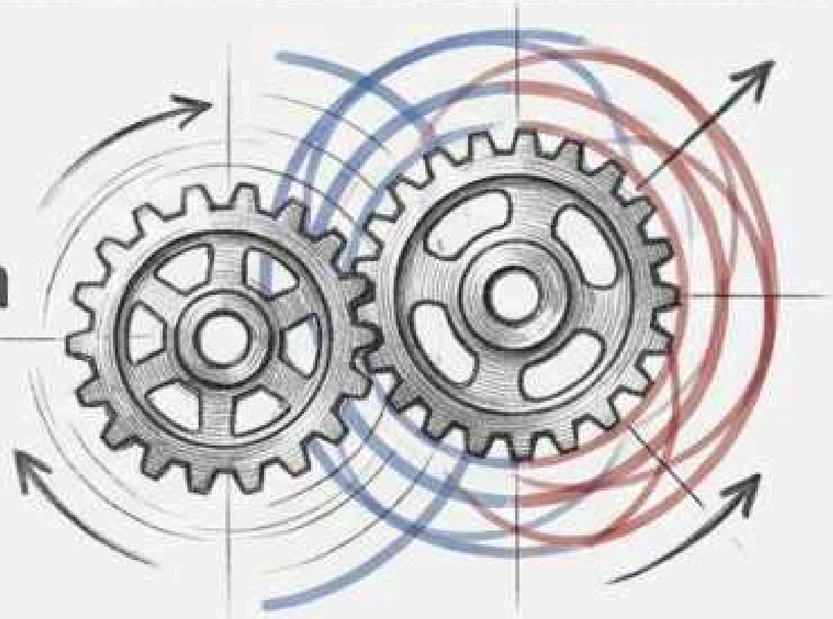
¶ 1.4

Transfer
(Zero-Sum)



Trade is **NOT a transfer**.
One side's gain is not matched by another's loss.

Value Creation
(Positive-Sum)

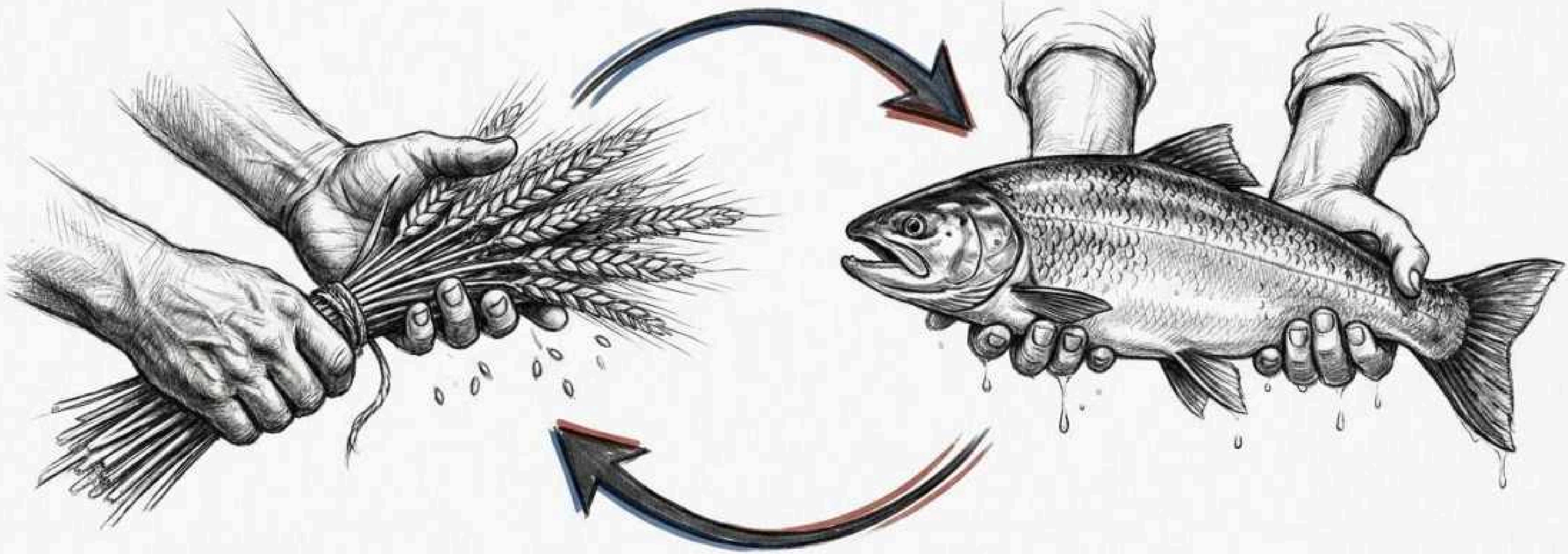


A market is a network of millions of these **voluntary, value-creating** trades.

Why trade? Differences in: Tastes, Skills, Resources.

Pillar 2: Specialisation
Concentrate on what you do best → Swap for the rest.

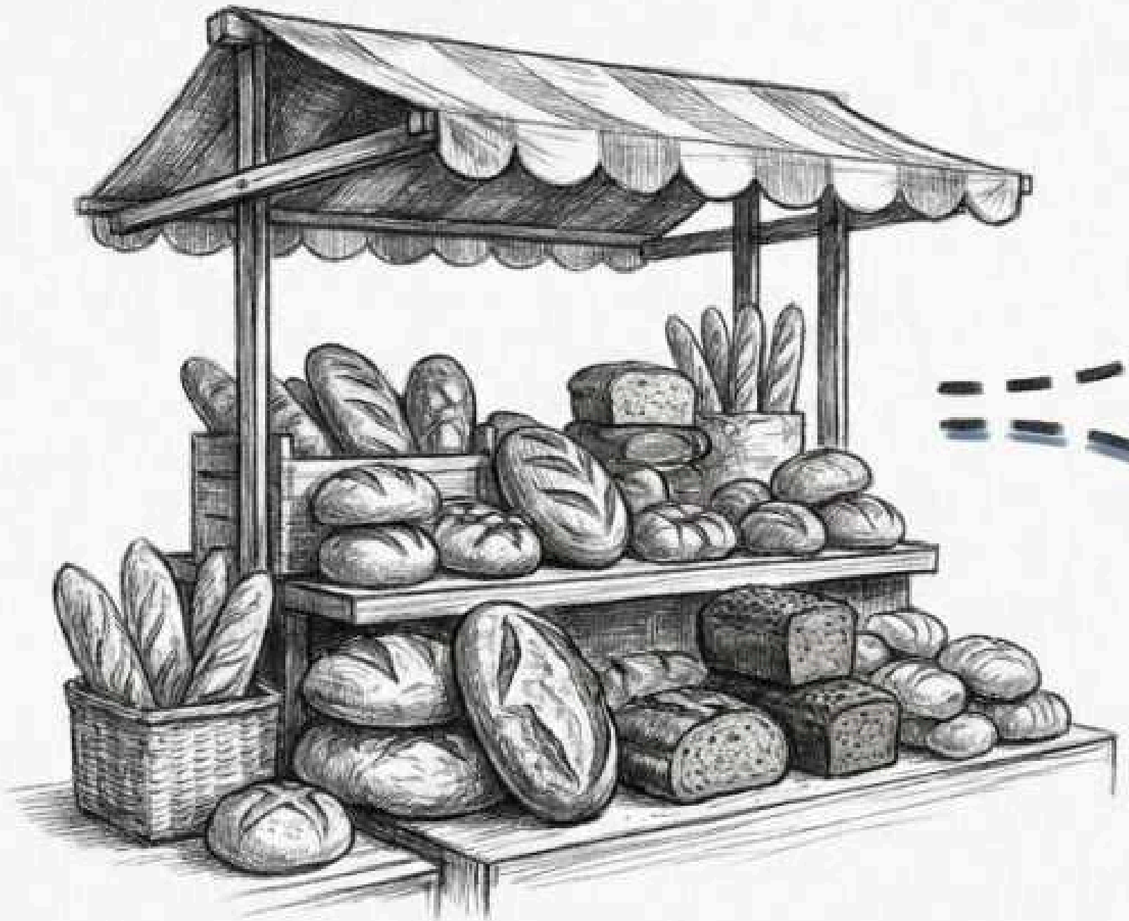
¶ 1.5



Markets serve diverse preferences simultaneously.

¶ 1.6

No voting required: Each buyer chooses for herself.





Rosa

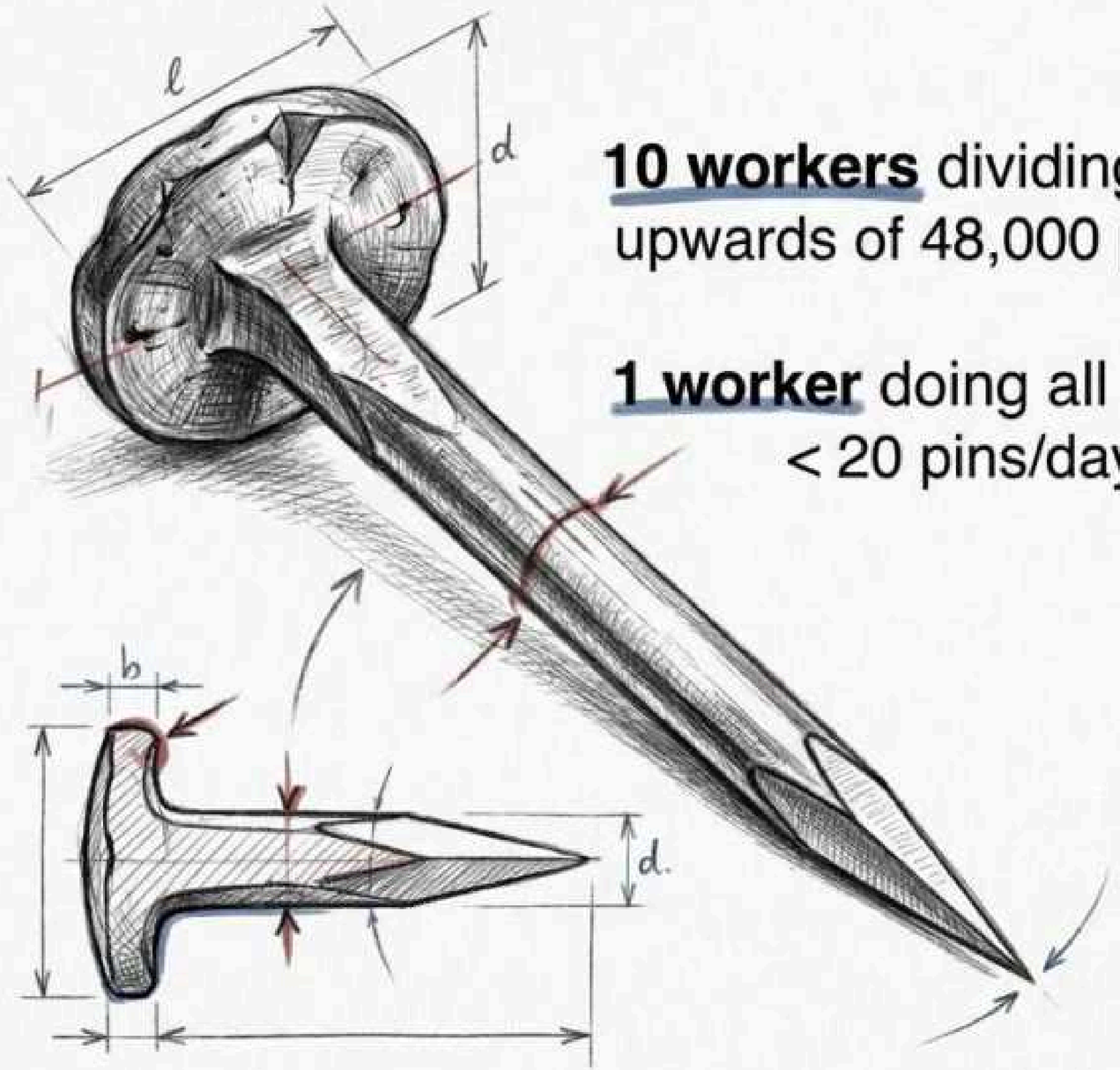


Rosa's neighbor

?

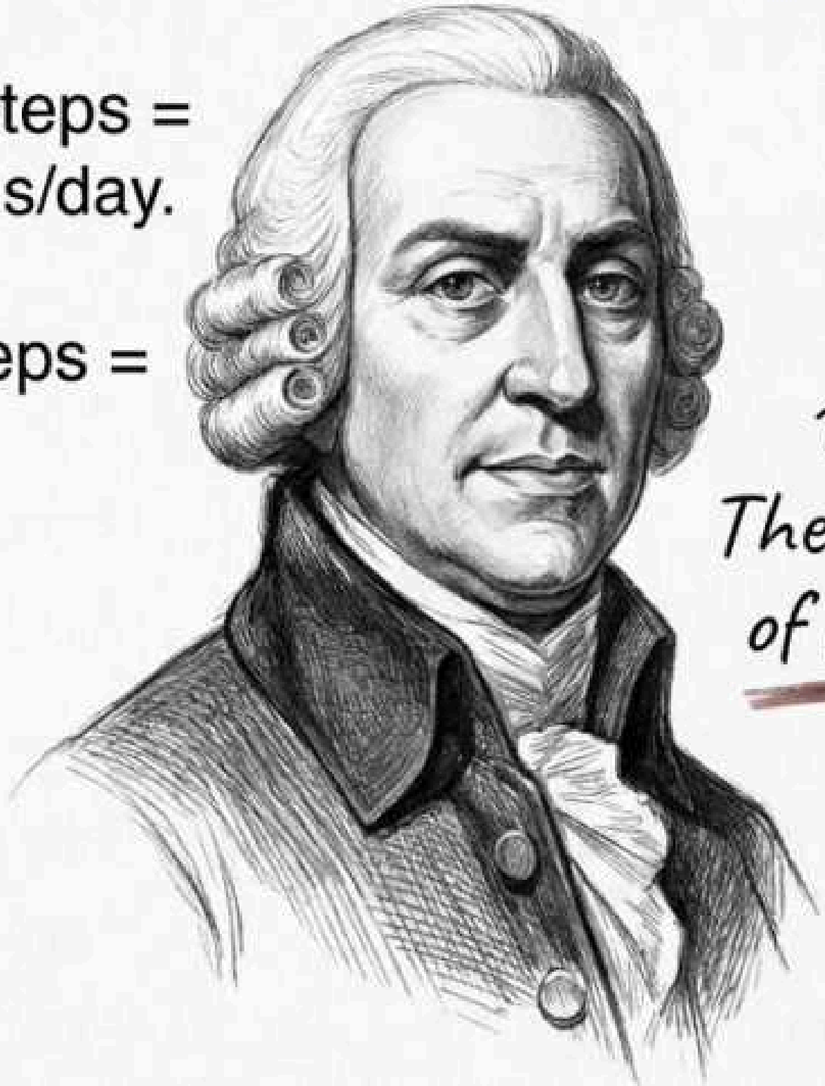
Are preferences shaped by advertising?

¶ 1.7



10 workers dividing steps =
upwards of 48,000 pins/day.

1 worker doing all steps =
< 20 pins/day.



1776
The Wealth
of Nations

¶1.8

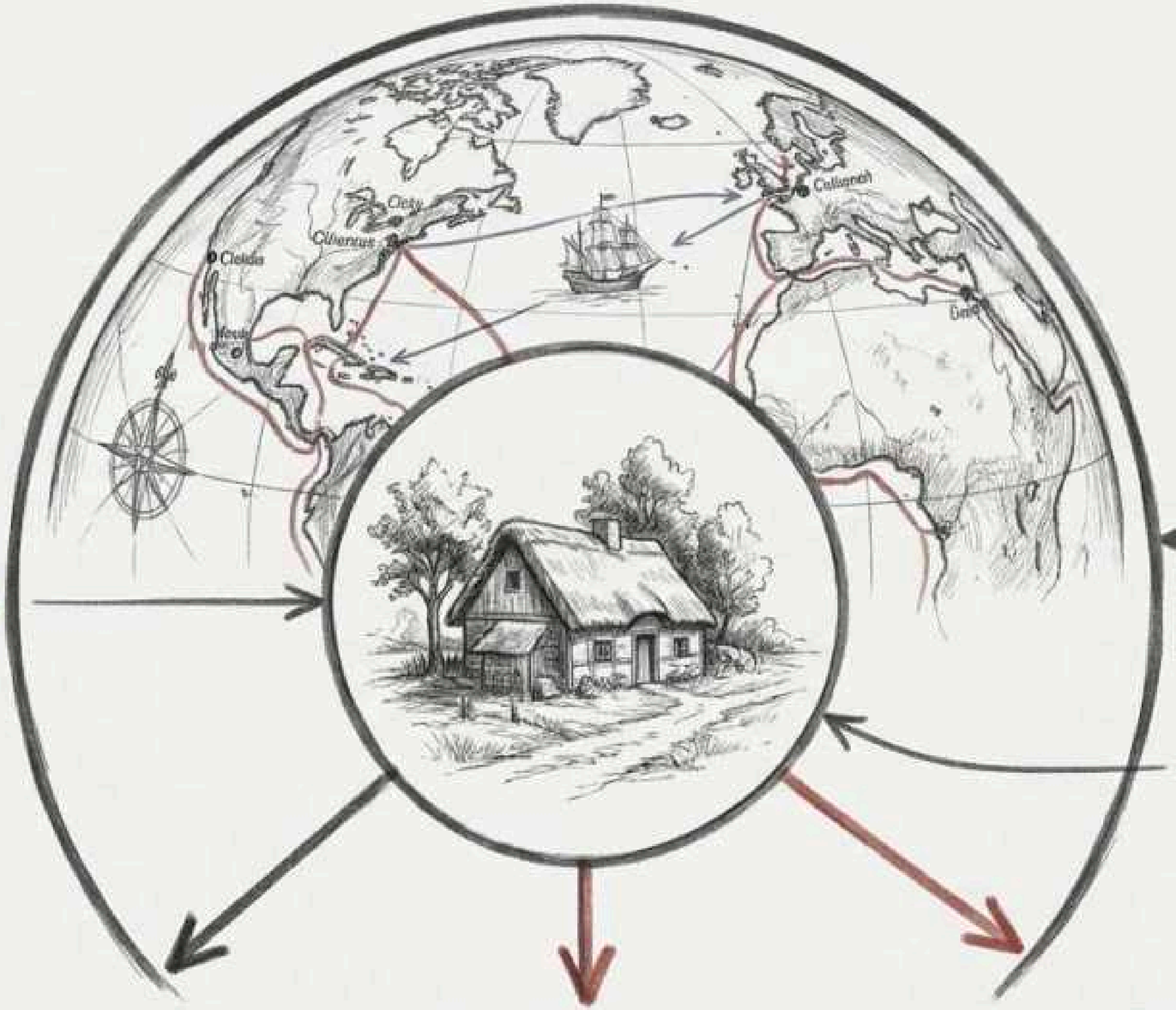
$$\frac{48{,}000 \text{ pins}}{10 \text{ workers}} = 4{,}800 \text{ pins/worker}$$

$$\frac{4{,}800}{20} = 240\text{x Productivity Multiplier}$$

Why?

- ↑ Skill (via repetition)
- ↓ Task-Switching Time (zero lost time)
- \+ Machinery Invention (for simple tasks)

¶ 1.9



National / World Market

Village of 1,000

Cannot support a pin factory.

Supports ultra-specialisation.

The division of labour is limited by the extent of the market.

Bigger market → finer specialisation → higher output per person.

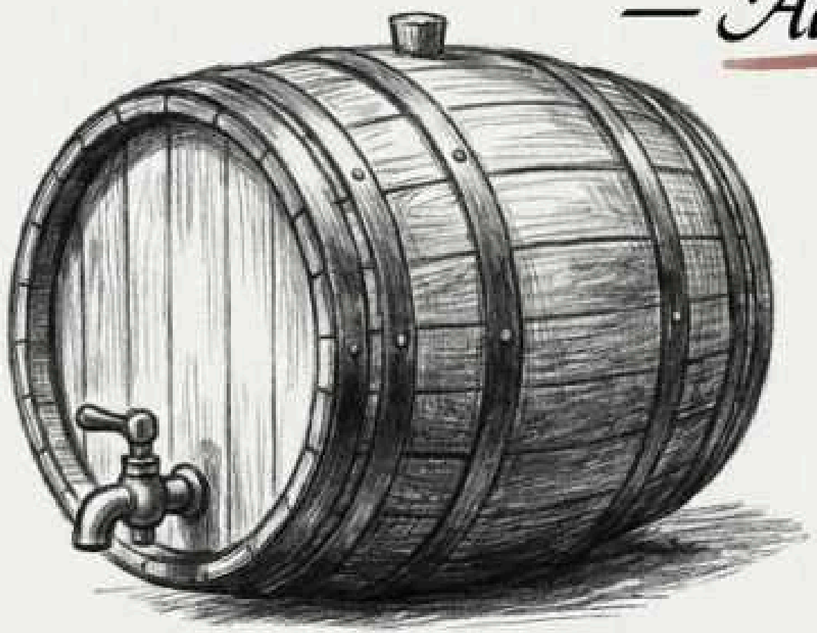
The Price of Specialisation: Dependence on Strangers.

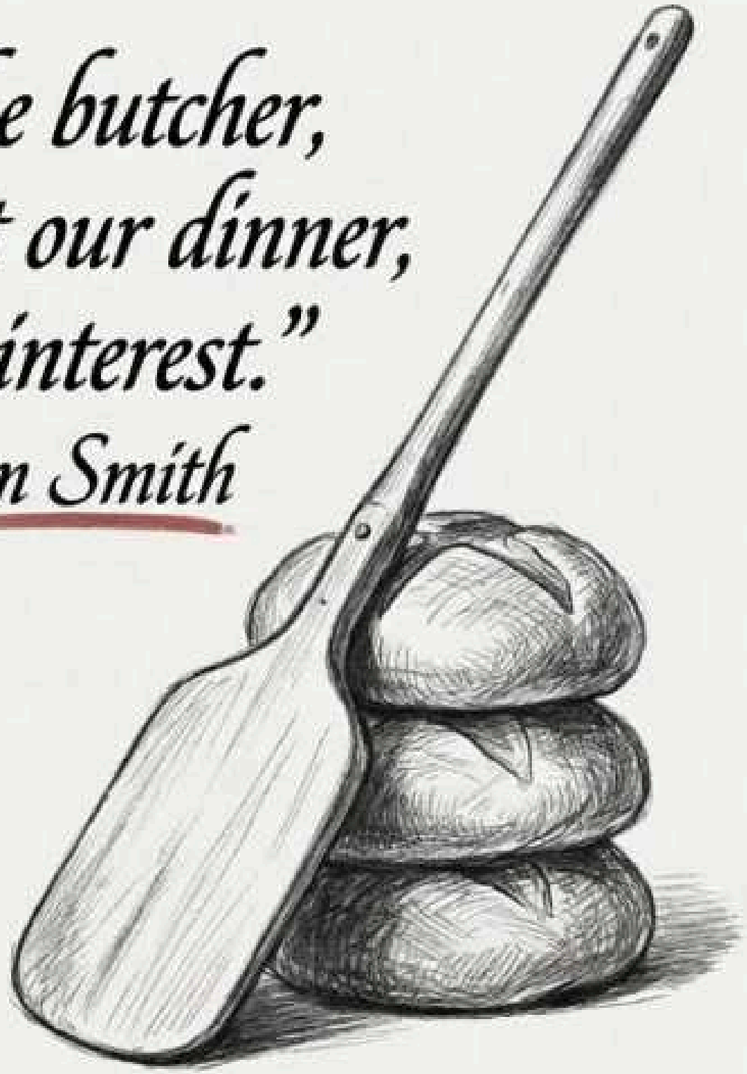
¶ 1.10

"It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest."

— *Adam Smith*





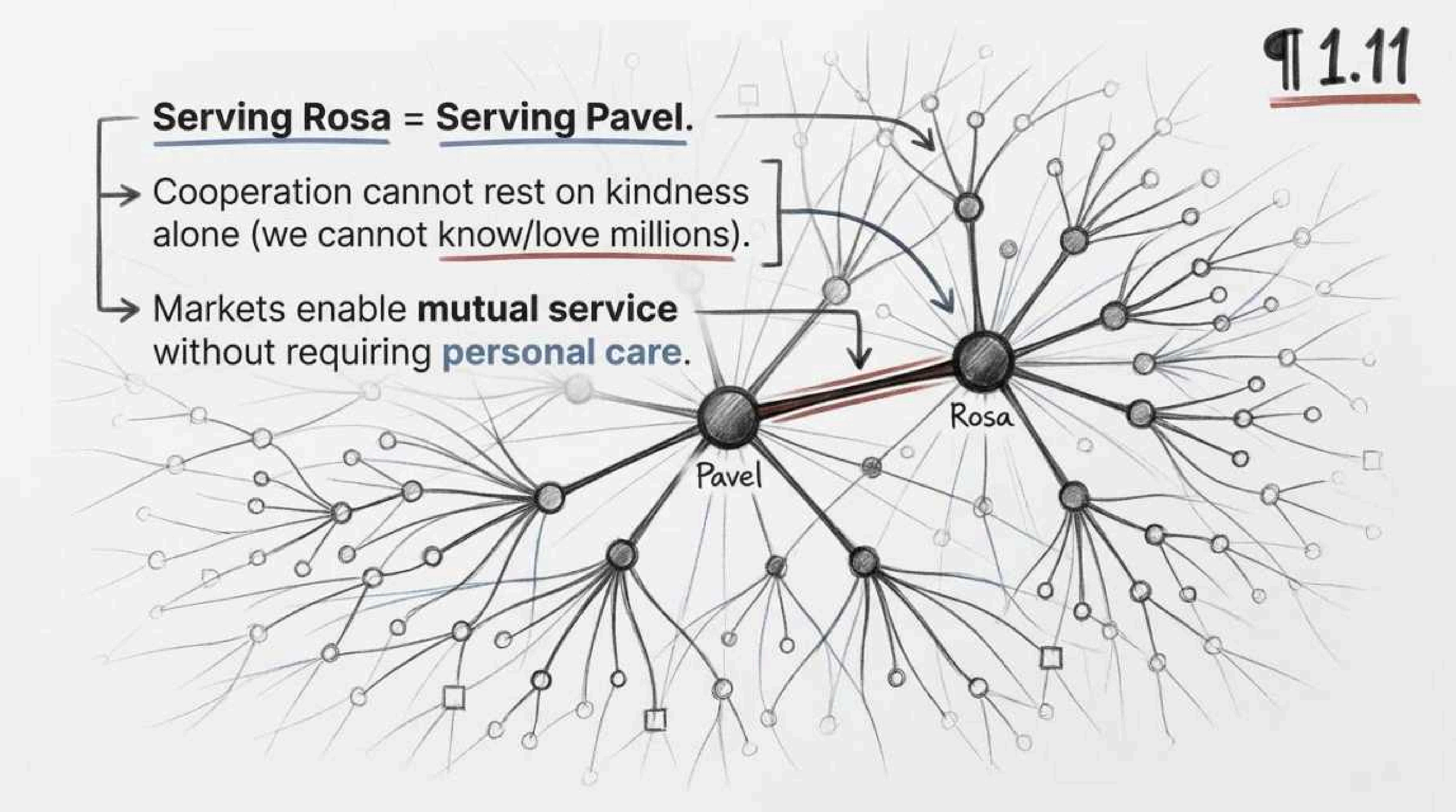


¶ 1.11

Serving Rosa = **Serving Pavel.**

→ Cooperation cannot rest on kindness alone (we cannot know/love millions).

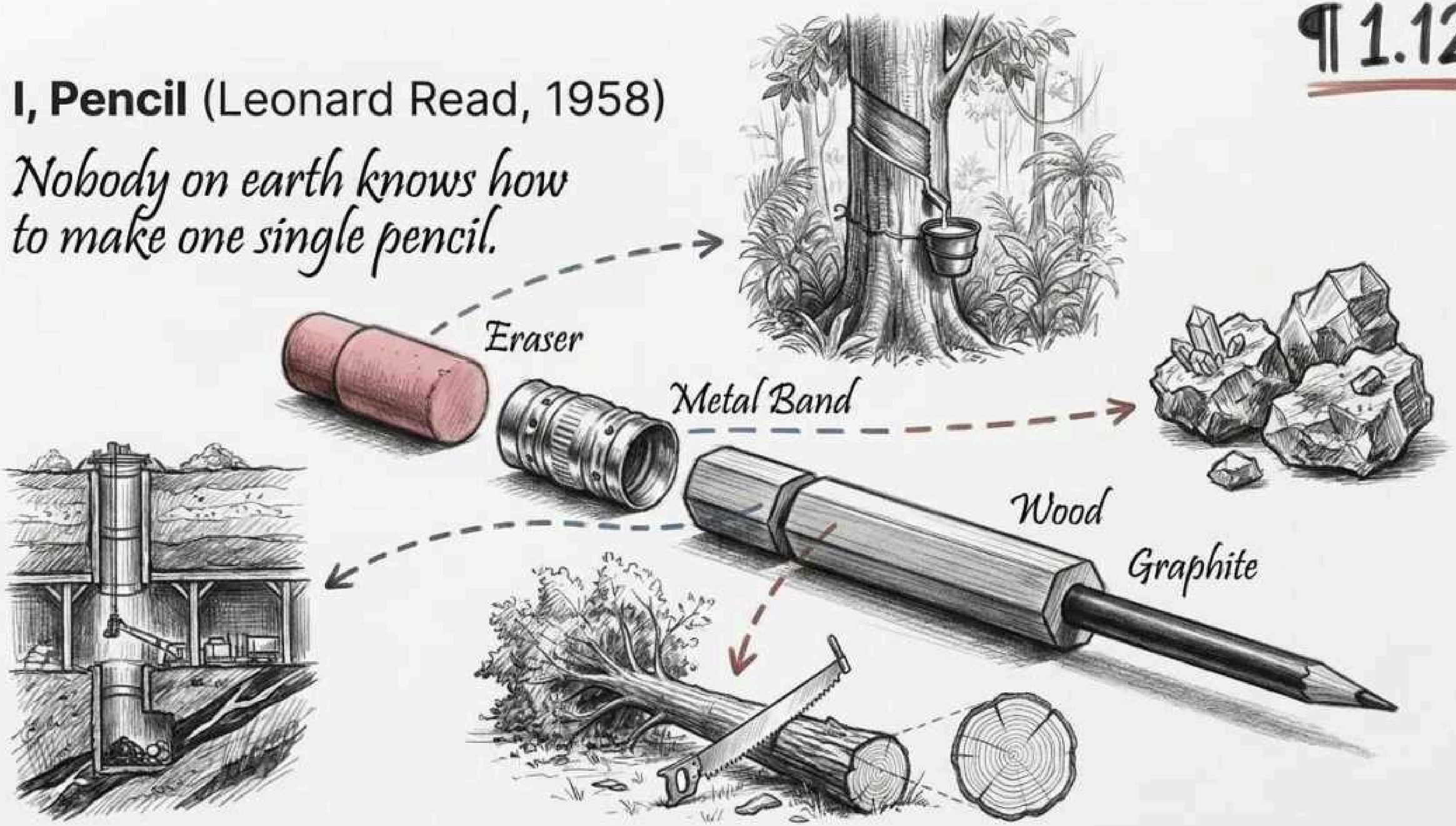
→ Markets enable **mutual service** without requiring **personal care**.



¶ 1.12

I, Pencil (Leonard Read, 1958)

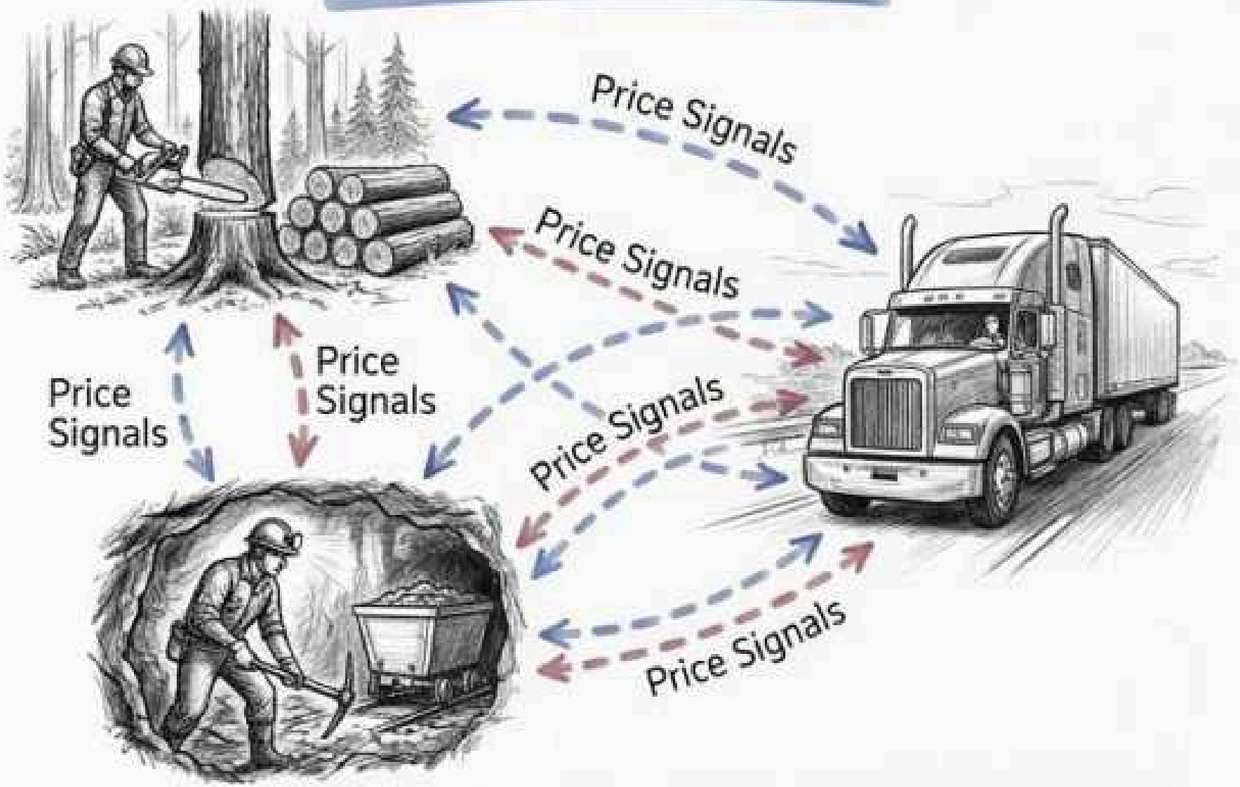
Nobody on earth knows how to make one single pencil.



Committee



Price Signals



Complex order arises from simple, price-driven exchanges, without an overall designer.

Thousands of strangers contribute for a product that costs a few cents.

The Metaphor

A merchant seeking his own gain is led to promote the good of society.



The Theorem (Reality)

It is NOT absolute.

Modern economics tests the exact conditions where free exchange equals efficiency.



1. Secure Property Rights

Must own what you trade.

2. Enforced Contracts

Promises must be kept.

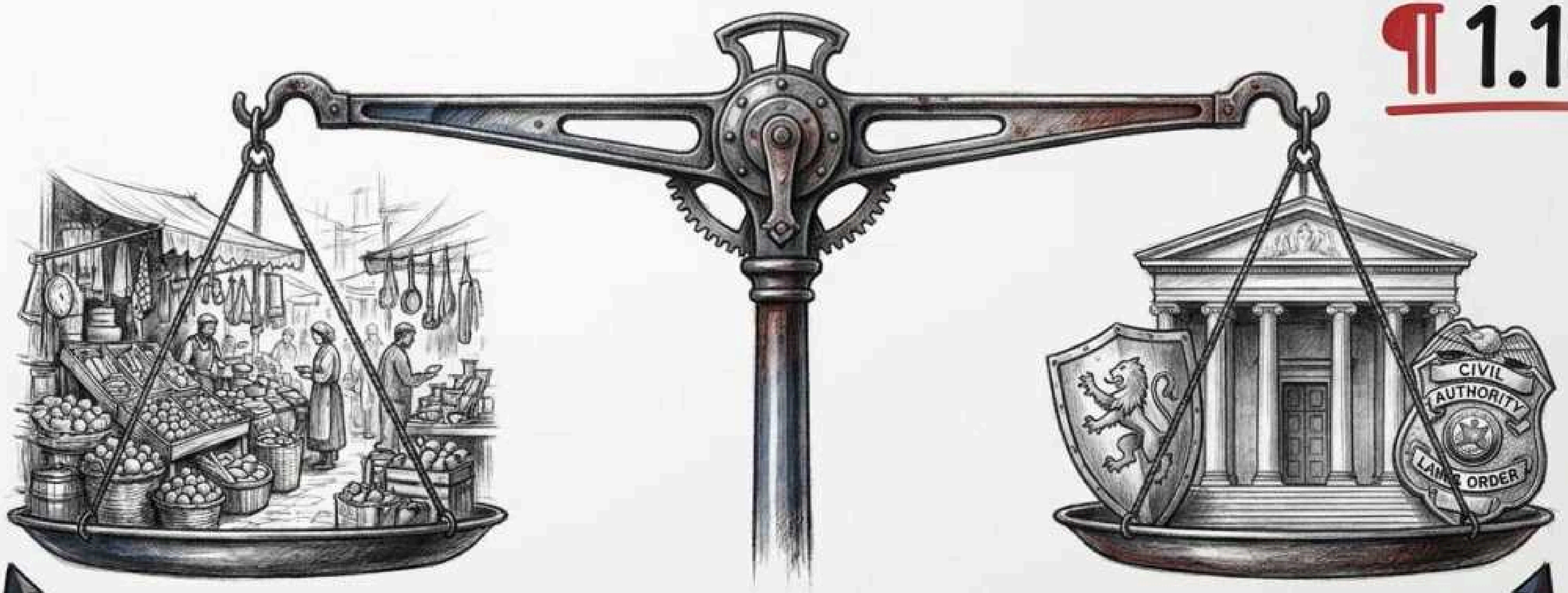
3. No Fraud or Force

Deals must be voluntary.

4. Freedom of Choice

Pick work and partners freely.

¶ 1.16



Free market ≠ Absence of government.
Someone must enforce the rules.

marginalia annotation

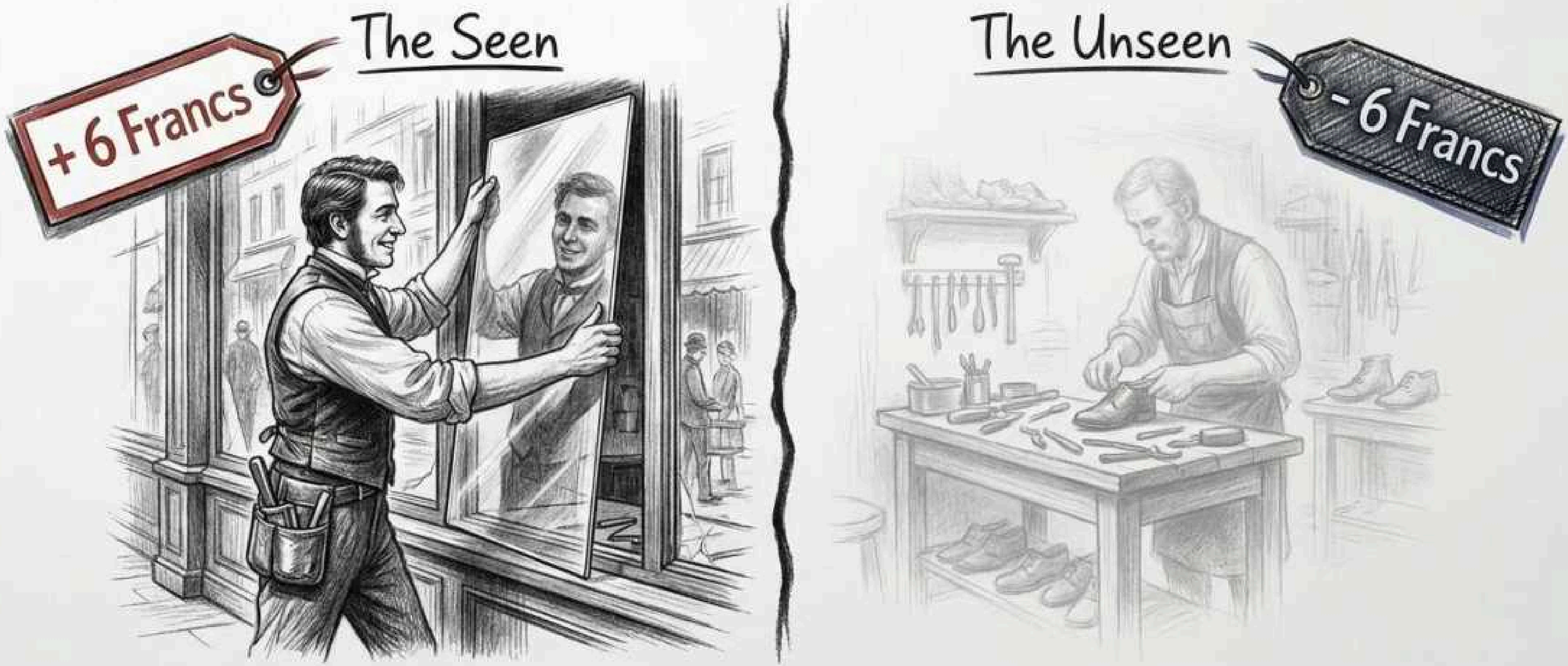
Consensus: Smith, Hayek, and Friedman all agreed government must provide defence, courts, and property protection. The debate is over how much more it should do.

defence →

The Broken Window Fallacy.

¶ 1.17

The seen gain is perfectly matched by an unseen loss.



¶ 1.18



Choice = Gain – Opportunity Cost







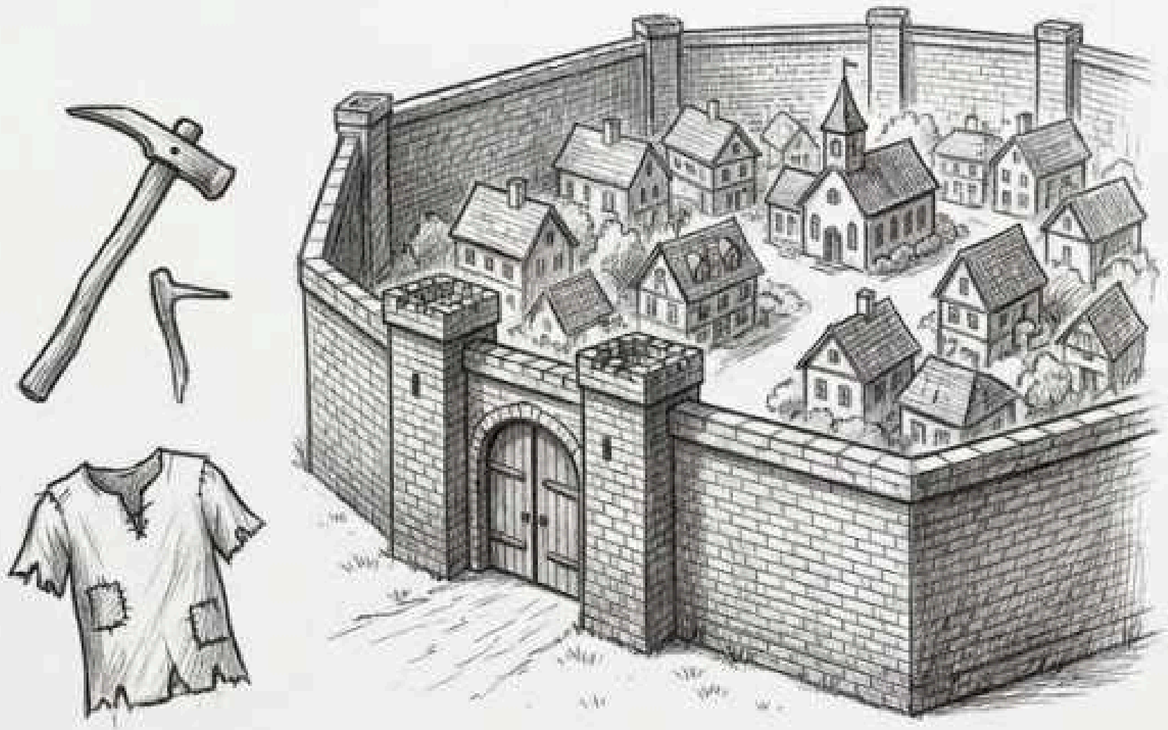
Bastiat's lesson = Opportunity Cost
(Resources used one way cannot be used another).

Prices are signals: A rising flour price tells every user that flour has other valuable uses being given up.

The free-market case in miniature.

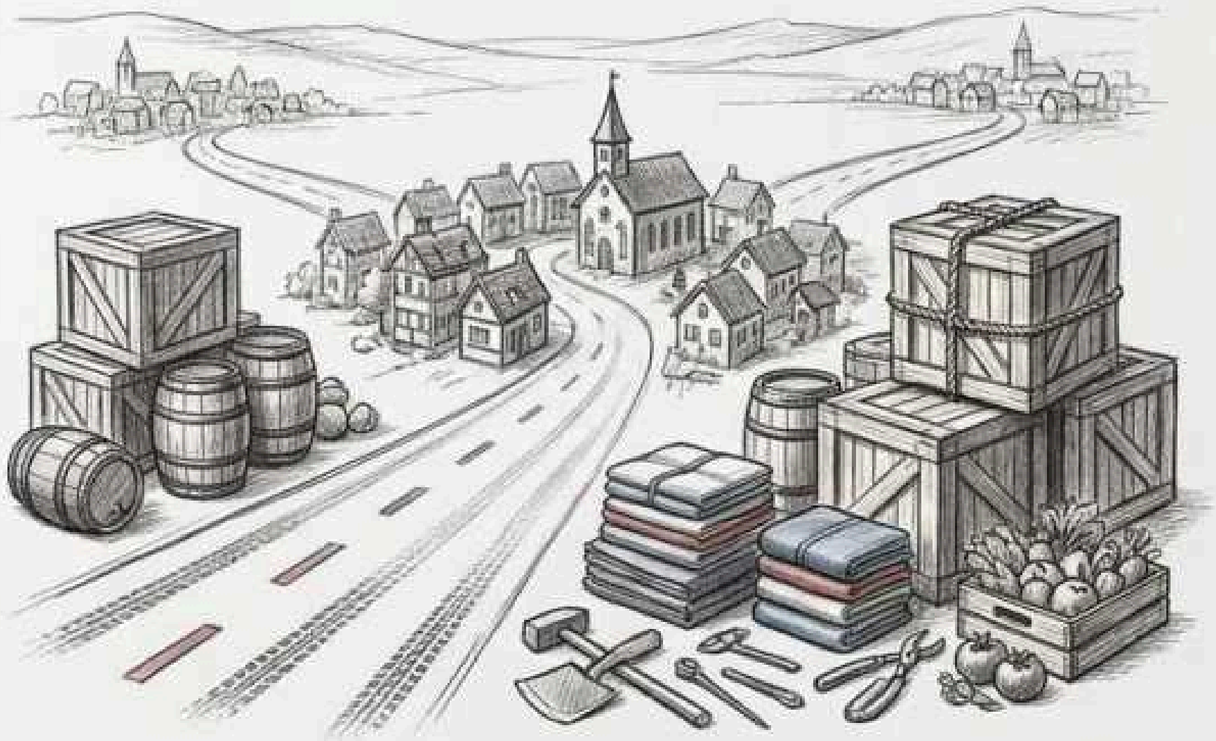
¶ 1.19

Before (Autarky)



↳ Wide skills needed, little time to improve, low yield.

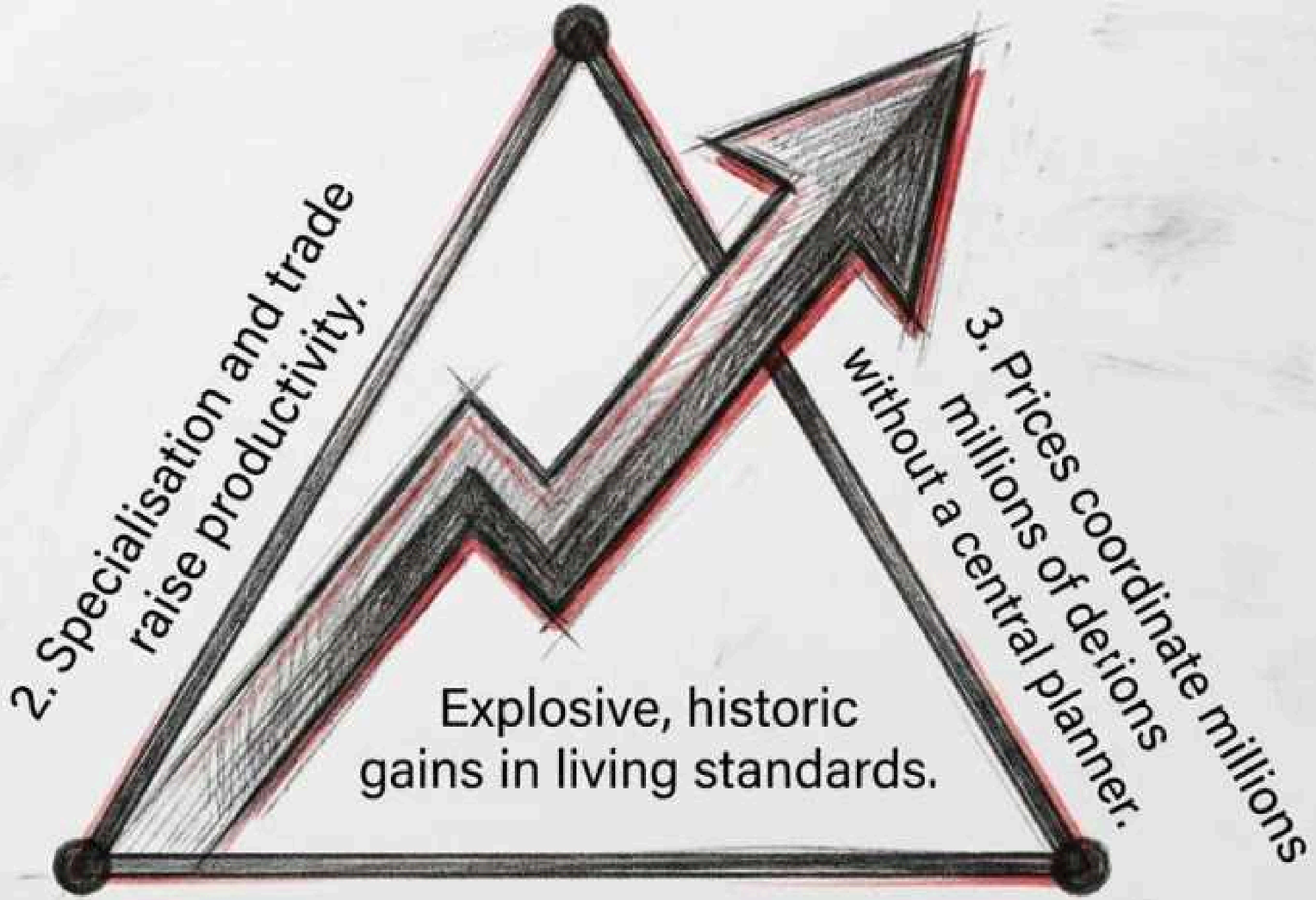
After (Trading)



Households specialise, productivity spikes, everyone has more.

The 3 Claims of the Free Market

¶ 1.20

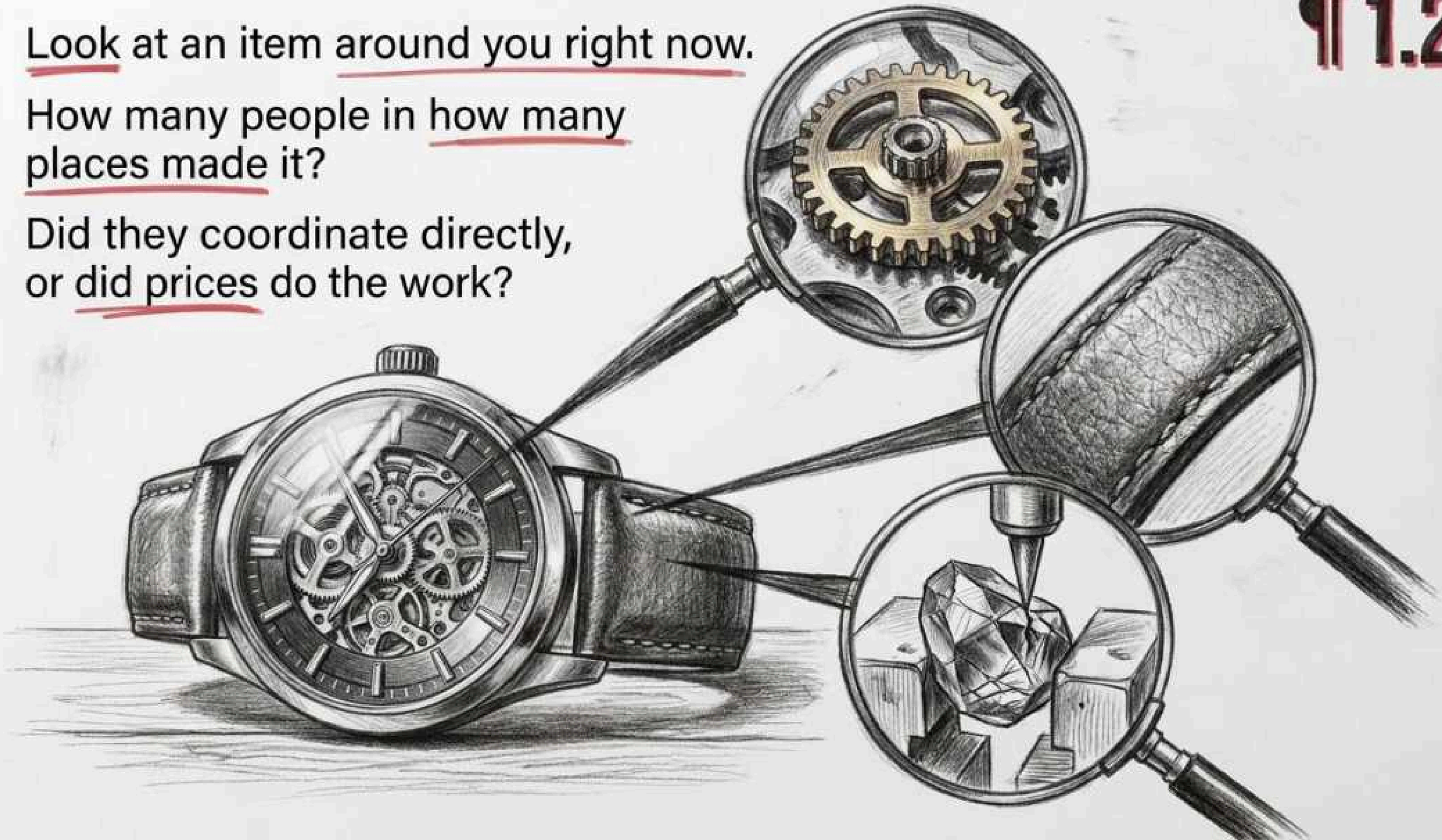


¶1.21

Look at an item around you right now.

How many people in how many places made it?

Did they coordinate directly, or did prices do the work?



Next Up – Lecture 2:

How do prices carry the knowledge that makes this global coordination possible?

