PEIS 101

Modern Theories of Political Economy
Introductions, etc.

- Beverly Crawford
- Eli
- The syllabus is at:
  - http://bev.berkeley.edu
- Facebook Group: “Political Economy”
- Book: The Political Economy Reader
- Other readings online and also available at Copy Central
Requirements

- Required attendance at all class sessions
- Come to class on time
- Class participation
- Complete reading for each session before class
- Please....no use of lap tops and smart phones in class...take notes with pen/pencil and paper
- Required subscription to the *Wall Street Journal* or *Financial Times* newspaper
- Complete three newspaper Assignments, February 18, April 6, April 27 (late papers will be penalized)
- Complete one midterm exam (March 9) and Final exam (May 14)
I will .......

- Post all lecture outlines/slides on the course web site
- Post course information on the Facebook Group page (and B-space if necessary
- Incorporate your comments and questions into the course
- Hold voluntary section discussions on the reading material Tuesdays and Thursdays from 5-6 p.m.
- Hold office hours Wednesdays 4-5 in 127 Moses.
- Be available by email bev@berkeley.edu and through the Facebook group
Political Economy

Power and Wealth

Two of the three most important forces in human life—politics and economics—are inextricably linked but two forces which actually oppose one another in the present period.

The relationship between power and wealth. Two of the most important driving forces in the world today.

The psychology of political economy is not very attractive:

– pursuit of wealth driven by greed and envy;
– pursuit of power driven by pride and insecurity.

They are related.

Is there a difference between power and wealth? Don't both involve the control of vast amounts of resources? Yes, but with wealth you control only material resources that can be translated into money. With power, you control resources that aren't tangible—wealth gives you material goods to satisfy your greed for more things—power gives you something else that every human being wants—recognition and security.

Indeed, most of life is dominated by this non-materialistic need for respect and recognition—and security.
What is this?

North Korea seeks power—not because it will necessarily create wealth, but because it wants respect, a seat at the table, the (illusion of) security that may come with respect.
Wealth and Power are Closely related

- But HOW are they related?
Political Economy is about an institutional relationship

- between the institutions of Wealth and Institutions of Power.
- Between the markets and governments.
What will happen as you do the work for this course:

• You will see the world differently
• You will know more where you are headed
• How? You will look at different and opposing arguments about the relationship between politics and economics
  – 1. The international financial crisis
  – 2. National and global wealth and poverty
  – 3. Why wealth and power seem to be shifting from the United States to Asia and other rising economic powers?
  – The environment
• What you will learn: to figure out what you need to know in order to judge for yourself what the better argument is.
Why do we need that skill?
Are we living in the best of times or the worst of times?  A time of Change

IT WAS THE BEST OF INVESTMENT TIMES.
IT WAS THE WORST OF INVESTMENT TIMES...
Two institutions: markets and democracies have come to dominate political economy

- Markets and democracies (with some modifications and holdouts)
- In particular, the institution of the market has spread around the globe: markets spread wealth
- and democracies disburse power---so that each of us has some. When each of us has some power, we have the freedom to do what we want.
What unites the two institutions?

- Theoretically both are based on the principle of freedom of choice-

- Some believe that the marriage of free markets and democracy would spell what Fukuyama calls the “end of history” a state of global peace---because markets seem to be good at producing and distributing wealth--and they permit people to be FREE to buy and sell as they choose.

- These two institutions are built on the Value of Freedom, as the foundation of political economy
Do Markets and democracy Create Winners?

- A rise in Living Standards
  - Living standards have risen dramatically over the last decades.
  - The proportion of the developing world’s population living in extreme economic poverty—defined as living on less than $1 per day—fell from 31.35% to 20.70% between 1981 and 2004.
  - Infant mortality rates in low- and middle-income countries fell from 86 per 1,000 live births in 1980 to 60 in 2002.
  - Life expectancy in these countries has risen from 60 to 65 between 1980 and 2002.
  - For more health, nutrition and population statistics, see the HNPStats database.
- Adult literacy has also improved, though serious gender disparities remain.
  - Male adult literacy (% ages 15 and over) rose from 78% to 83% in low- and middle-income countries between 1990 and 2002.
  - While female literacy rates rose from 62% to 70%.
Gross World Product, 1950-2005

Source: IMF, Worldwatch
But markets also create losers…

- Market economies have high levels of inequality—both nationally and globally.
  - Nationally: the gains from American productivity have gone to just a small segment of the population—those already in the upper part of the distribution. As a result, inequality has grown.
    - From 1997 to 2001, nearly 50 percent of productivity gains went to the top 10 percent of the distribution.
What about economic inequality?

• But markets create losers

• A low Gini coefficient indicates a more equal distribution, with 0 corresponding to complete equality, while higher Gini coefficients indicate more unequal distribution, with 1 corresponding to complete inequality. To be validly computed, no negative goods can be distributed. Thus, if the Gini coefficient is being used to describe household income inequality, then no household can have a negative income. When used as a measure of income inequality, the most unequal society will be one in which a single person receives 100% of the total income and the remaining people receive none (G=1); and the most equal society will be one in which every person receives the same percentage of the total income (G=0).

• Some find it more intuitive (and it is mathematically equivalent) to think of the Gini coefficient as half of the Relative mean difference. The mean difference is the average absolute difference between two items selected randomly from a population, and the relative mean difference is the mean difference divided by the average, to normalize for scale. Worldwide, Gini coefficients for income range from approximately 0.247 (24.7) in Denmark to 0.707 (70.7) in Namibia although not every country has been assessed.

• As a mathematical measure of inequality, the Gini coefficient does not necessarily entail any value judgement, i.e. the "rightness" or "wrongness" of a particular level of equality.
The United States...

• From 1995 to 2005 The United States was the most productive of all of the OECD countries except Sweden, Iceland, and Finland.

• When you are productive, you have economic growth. US economy grew by 3.27% during that period of productivity, slightly behind Finland, Iceland, and Australia.
Wealth is concentrated

Distribution of Wealth in the U.S., 2001

- Top 1% own 33%
- Next 4% own 26%
- Next 5% own 12%
- Next 10% own 13%
- Next 20% own 11%
- Middle 20% own 4%
- Next 22% own 0.3%
- Bottom 18% have zero or negative net worth
Decline in real wages

Real Wages Struggle
Average weekly earnings of U.S. workers in 2008 dollars, since 1964

Source: Federal Bureau of Labor Statistics, FactSet
Much of the World doesn’t fare as well as US workers.....
Why?

• Different Theories have different answers
• One answer claims that the market favors winners, those who are most productive.
• And the market itself is dynamic......
The Market is dynamic: The Business Cycle

- **Prosperity Phase**: The economy is operating at or close to full capacity. Increased lending by banks and some combination of consumers, firms, and increased aggregate demand for loans will cause interest rates to rise above the expected return on investments. Wage demands gain, and production inputs become expensive. As costs of doing business increase, profit margins to some firms, layoffs from unions, and the rate of investment as businesses concentrate on more worker laying off rather than developing and selling products.

- **Transition Phase**: Demand slackens, and consumer and business spending slow. Firms try to streamline production by reducing the workforce and wages. The general becomes increasingly pessimistic as income, demand, and investments decline. Rising protectionism and currency devaluation... international trade was cut or abolished by national authorities to protect the national economy. This led to international finance being cut and globalization being halted by nationalist forces in the industrialized North. The Bretton Woods system came to complete end, creating a new global economic order without a stabilizing hegemon. Inflation (resulting from the boost in price of a central input to the economy) was accompanied by massive capital losses to many states. This provided counter-cyclical policies and led to debt crises and lost decade of international growth.

- **Recovery Phase**: The cycle will start over. Investment starts to pick up as inventories run down and marginal returns on new projects exceed the costs of borrowing. Businesses start to buy more inputs and spend more, new jobs spur consumer spending. This recovery phase leads to prosperity phase.

- **Recession Phase**: The economy moves toward the trough of the cycle, a demand for loans will cause interest rates to rise above the expected return on investments. Wage demands gain, and production inputs become expensive. As costs of doing business increase, profit margins to some firms, layoffs from unions, and the rate of investment as businesses concentrate on more worker laying off rather than developing and selling products.
Another view: Is the Market unfair?

• In times of both prosperity and depression, the poor and the losers may seek power to obtain what they see as their “fair” share of the wealth.

• The wealthy seek power to maintain their “fair” share of the wealth

• All want government intervention in the “trough”

• What is “fair?”
Or just too harsh.....All call for Govt. intervention in the Trough

- Prosperity
- Transition
- Trough
- Recovery

Here we are ↑

Labor and Capital want Government Intervention
When the market is perceived as “unfair,” or just too harsh....those hurt turn to government to protect them

• But what should the government do?
• In the trough, should government......
  – Provide universal health care?
  – Bail out Wall Street?
  – Bail out Main Street?
  – Leave well enough alone—stay out of the market?
And countries can be “losers” in the market too. (because markets are based on the idea that freedom of economic choice will create the most wealth for the most efficient and productive, countries that don’t win in the international marketplace will fall behind.

China surges ahead
Closing wealth
And power gap
With the West
Should NAFTA be renegotiated because the US isn’t benefiting from it?

• Obama said he’ll unilaterally end NAFTA if Canada and Mexico negotiate what is “unfair” to U.S. workers.

• So democratic governments are tempted to restrict markets when they fall behind in market competition.....

• During the 2008 election campaign, McCain said free trade should remain free and unrestricted—that the government should stay out of the market.

• For both, we saw that when the market punishes those who are not creating wealth, political power should bail out the losers.
Many believe that Markets go through this cycle without government intervention.

- Prosperity
- Transition
- Trough
- Recovery
So what?

• When your country wins or loses in global competition, Your prospects are affected.
• Are you well-positioned to win in global market competition?
• Should the government intervene when it’s citizen’s prospects are dim?
• Or should the market correct itself?
• This course will help you figure out the answer
Theories of Political Economy provide answers

• But the answers are contradictory!
• They lead to opposing political beliefs
• They are theories about what political economy SHOULD be about.......not necessarily what it IS about......
Three Theoretical Approaches

• Each rests on a different value as its foundation
  • Freedom
  • Equality
  • Community
The Three Approaches

• This was McCain's position when he advocated free trade.

• The Second Approach we will discuss is based on the principle of equality—or more broadly, a critique of Liberalism— that focuses on "fair" distribution. Because the market creates winners and losers,

• The Third Approach is based on the principle of community. That the economy should work for the broader community— the nation—as a whole. The community at whatever level should control the market for the good of the community—the nation—as a whole. Economic Nationalism and Communitarianism. This approach also says that the state should run the economy, but it should allow markets to operate. The state, however, must control the markets. It must make sure that no other economic powers exploit its economy. It protects its own economy and promotes its businesses abroad. It is not laissez faire.