

**Economic Liberal
Theories of Political
Economy**

Are you here, focused, ready to learn?

- A. yes
- B. no

Takeaways from Last Week: Political
Economy is about



Purpose (goals), Theory, and Policy

The **Goals:** Freedom, equality, Community Goals are value-based and can't be tested

- Why does the State/government have to intervene in the economy to achieve its purpose?
- Because resources are limited and society's desire for them is unlimited
- Each purpose demands a different kind and size of state/government to allocate resources according to purpose.
- Theories are **arguments** about
 - what **policies/Institutions** are needed to achieve a particular goal.
 - And about desirable kinds and sizes of **governments** and policies.
- These arguments based on **assumptions** (about human nature, about justice, about what we deserve with regard to power and wealth) Not true or false....can't be tested
- Based on these arguments (theories) governments devise **policies** to achieve social goals.
- →hypotheses a bout cause-effect (example of price gouging laws vs markets) (policy)→predictions/policy prescriptions
 - Assumptions can't be proved true or false, but policies are like hypotheses that can be "tested"
 - the test: do policies achieve the intended effect to fulfill the policy purpose?

If the goal is to maximize individual freedom, then theories of Economic Liberalism shape Policy

- What does “liberal” mean here? (click on the best answer)
 - A. A big welfare state?
 - B. A highly regulated economy protecting workers rights, the environment, etc.?
 - C. Liberty especially from state control
 - D. The opposite of conservative

Theories of Economic Liberalism: Classical Theorists, Hayek, and Friedman (and some from PE 100)

- **Assumptions**

- Individual is at the center (Hobbes, Locke, Rousseau)
- Individuals are self interested (Hobbes)
- Desire for freedom of choice is natural (Hobbes, Locke, Rousseau)
- We are all born equal in our freedom to choose (H, L, R)
- Our choices are rational (H, L, R, Bentham and Mill)
- Private property is natural (Locke)
- Given all of the above, Markets arise “spontaneously” (Smith)

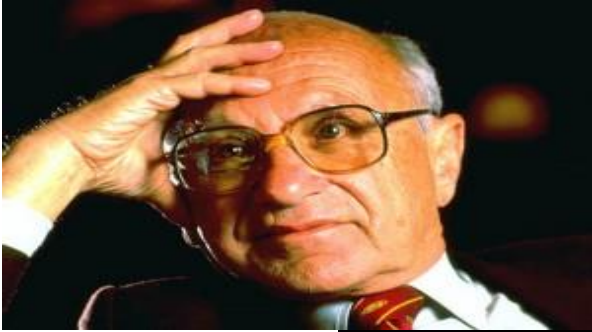
- **The hypothesis** (cause-effect relationship) (Adam Smith, Ricardo)

Markets: voluntary exchange → buyers demand goods → sellers produce them → buyers choose rationally (price and quality) → competition among sellers → efficiency → Division of Labor

- **The Prediction** (Smith, Ricardo)

- For the Individual: More freedom
- For production : More Efficiency
- For all: Freedom, Growth, Welfare, and Peace

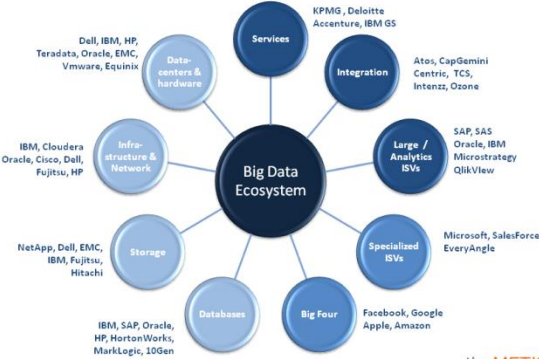
Assumption: Individuals are self interested



Examples



Big Data Ecosystem



What is the role of the government:

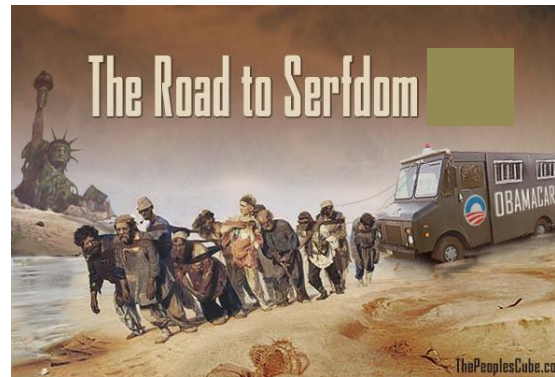


Fred Hayek

- **To** uphold the “rule of law”
- Clicker question: After the Gulf Oil Spill of 2010, The Obama Administration required BP to set up an escrow account to clean up the Gulf. This decision was
 1. Arbitrary and against the Rule of Law
 2. Within the role of Government authority to protect national territory

Clicker quiz:After the Gulf Oil Spill of 2010, The Obama Administration required BP to set up an escrow account to clean up the Gulf. This decision was.....

1. breaking the Rule of Law



2. Within the government's authority to protect national territory



What is the role of the government:



Fred Hayek

- To ensure competition in the market
- Why?
- It's the **most efficient**
- Ensures the **most freedom**
- If the state doesn't ensure competition, **monopolies** will develop—undermining freedom
- States also protect competition by regulating externalities

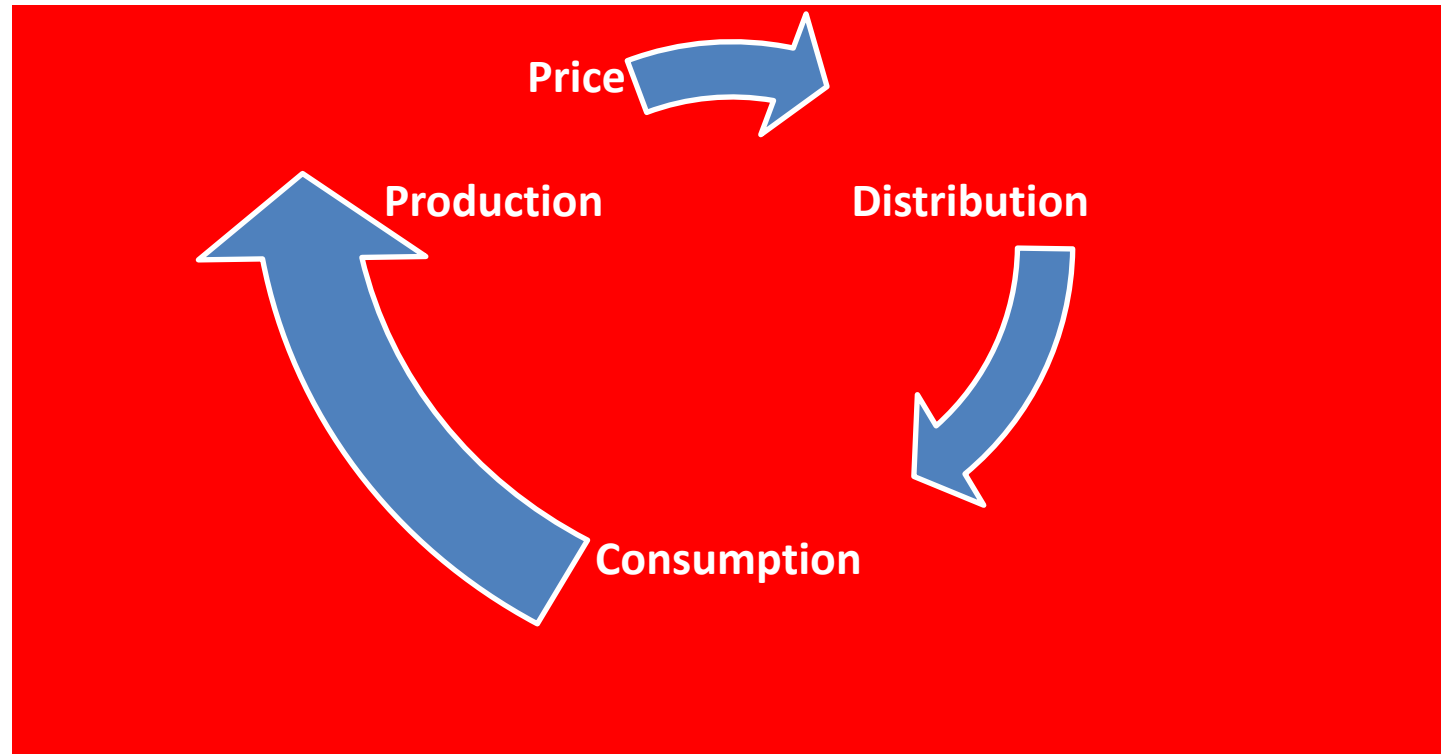
Clicker quiz: What would Friedman and Hayek think of Lyft and Uber

- A. They would approve
- B. They would disapprove

Example: A spontaneous Cocaine market



Market system of Resource Allocation

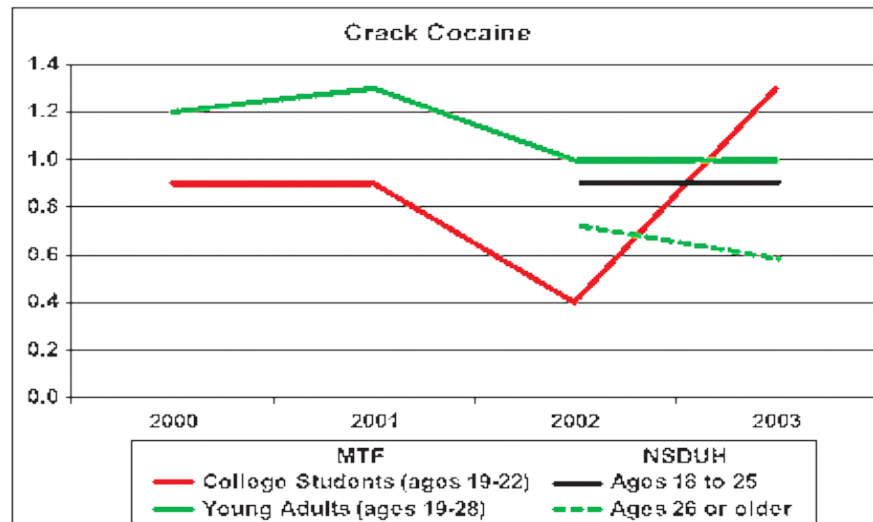
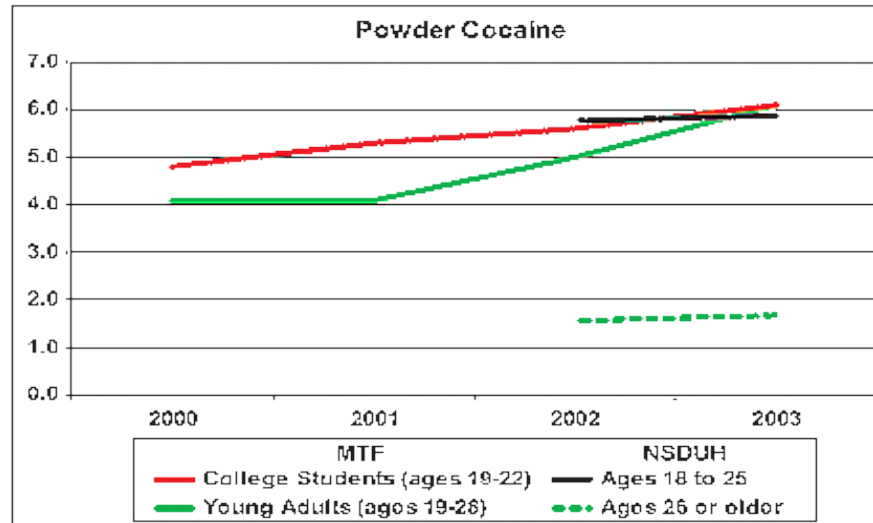


Supply (production) is driven by demand

Coca supply is abundant.....production costs low...
processing is easy and cheap, market is large



Demand is High and steady



Should price be high or low in a perfect competitive market for cocaine?



Illegality represses demand and supply, raising the price

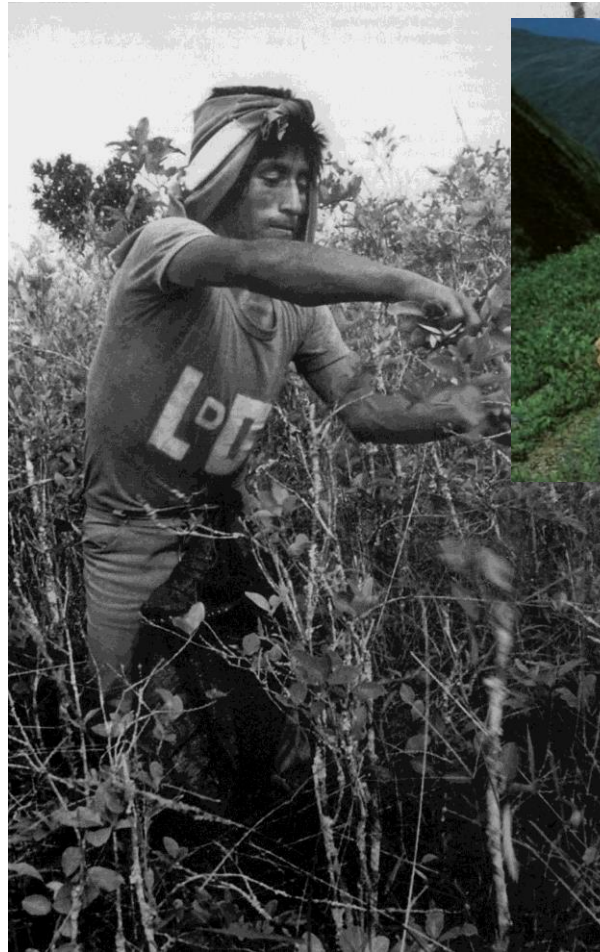


So It's rational to produce cocoa.....

**Corn: \$150 per
acre**

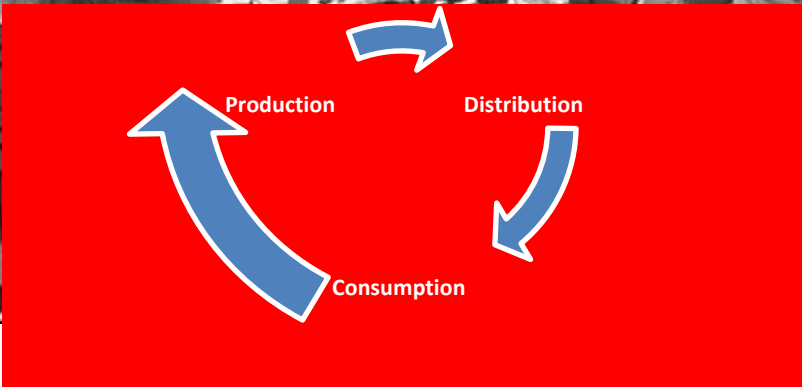
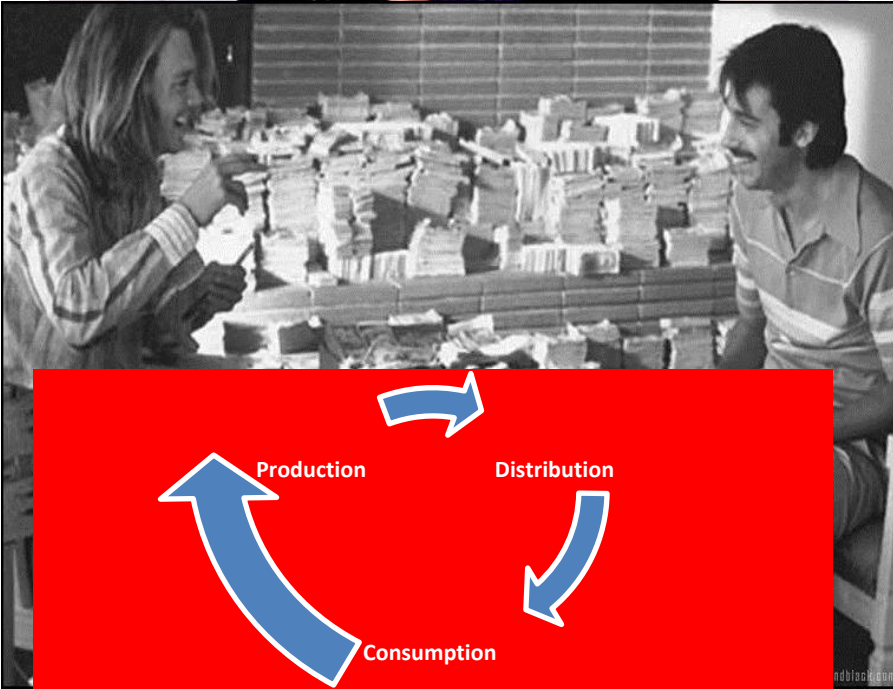
**Livestock: few \$
per acre**

**Cocoa: \$5-10,000
per acre**



**What crop
would a
rational farmer
grow?**

And rational to sell it.....



Why should the State ensure competition?



- Because monopolies limit alternatives for consumers
- Because monopolies block competitors from entering a market
- And therefore block freedom of exchange
- Therefore governments must determine and enforce rules of competition.....

So...applied to the drug trade: Illegality and high prices create drug lords with market monopoly. Monopoly creates.....

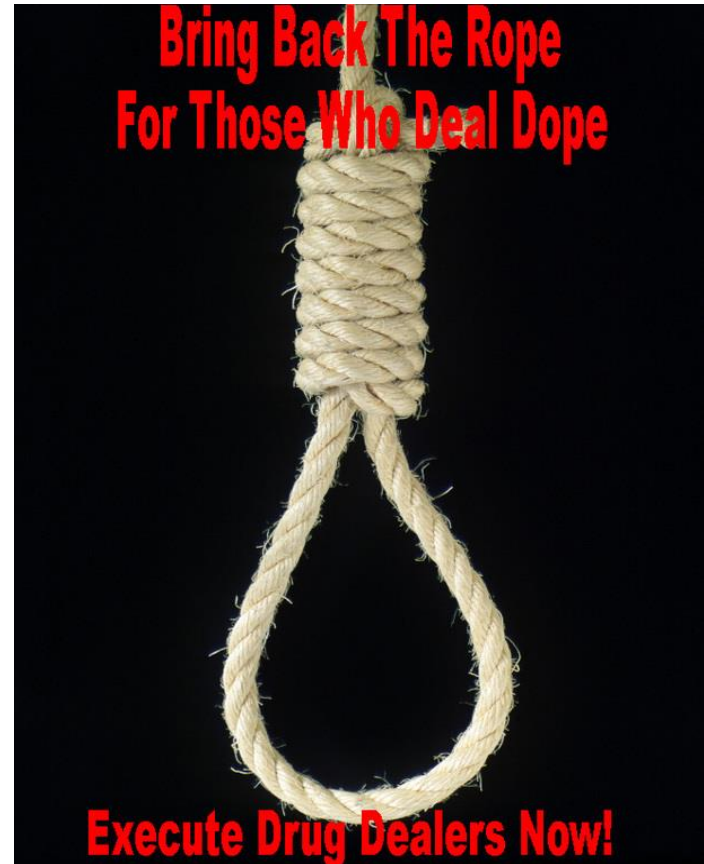
Obscene profits for drug lords

Pomona, CA
1/18/2006

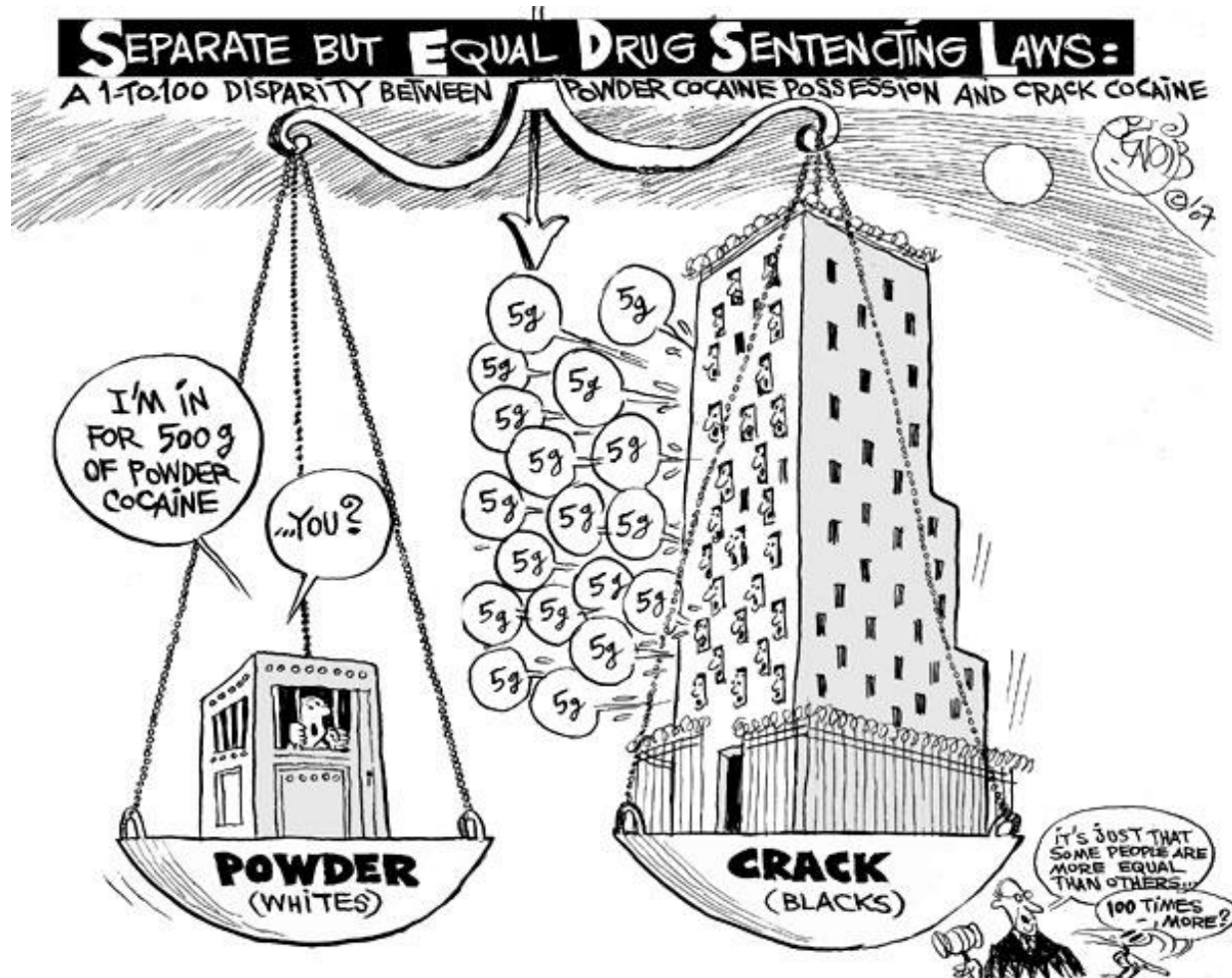
\$1,390,965.00 U.S. Currency



Govt. efforts to make the market illegal means coercion



And creating a nightmare of jails filled with casual drug users.....



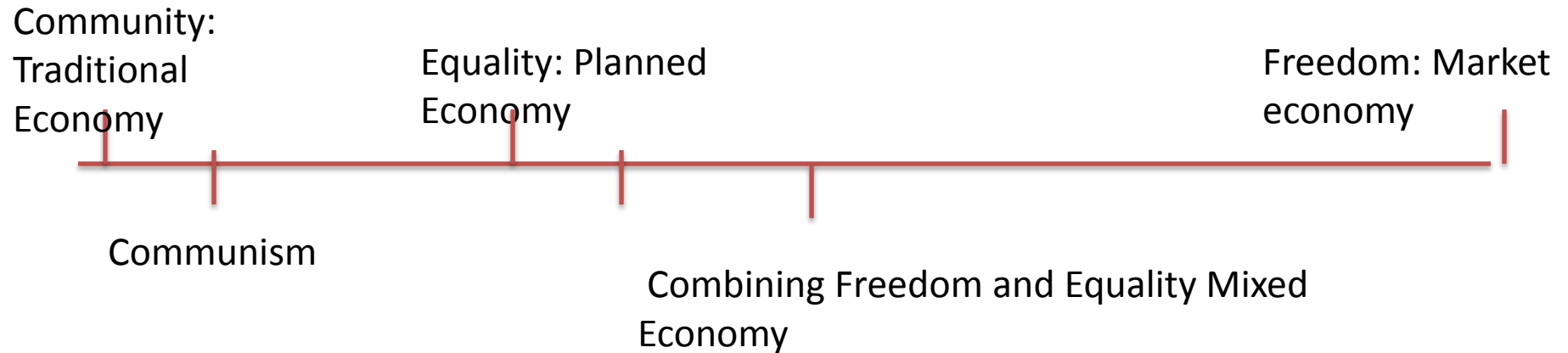
The Economic Liberal believes: The War on Drugs suppresses Freedom...



Summary:

- People make rational choices
- Rational people create spontaneous markets,
- Thus markets are “natural” and should be free
- Free exchange creates “true” prices—the most important information
- Thus states should stay out of markets.....
- Their job is to ensure competition
- They will never be powerful or wise enough to suppress natural and spontaneous markets

Institutions of Resource Allocation with varying degrees of state intervention according to social purpose



Free to choose? REALLY?



PLEASE DRINK RESPONSIBLY
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