

Economic Liberal Theories of Political Economy

Review

- What is Political Economy?

Today's Menu

- What is Theory?
- What is a state
- Sovereignty
- What are Systems of resource allocation?
- Institutions of Resource Allocation
- Liberal Systems and Institutions of Resource Allocation: The political Economy of Freedom
- Liberal Theory of Resource Allocation
- Assumption: Individuals are Rational
- Assumption: Individuals are self interested
- How do Liberals feel about the role of the State?
- Bailouts
- Example: The Drug Trade

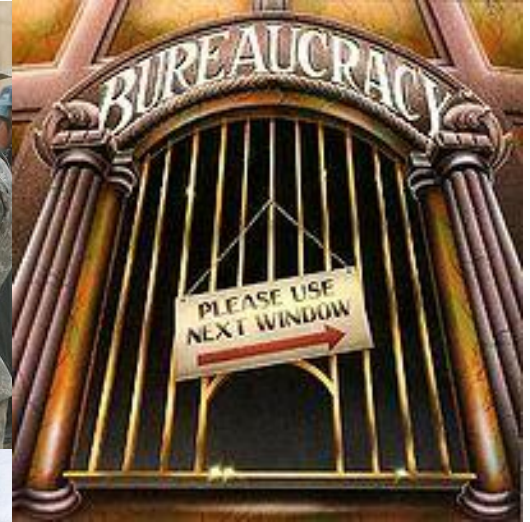
What is Theory (the way we will use it here)?

- Theories are arguments based on assumptions
 - Some assumptions about human nature
 - Some assumptions about institutions
 - Some assumptions about values/goals

Is there anything objective about this?

These assumptions combine to determine a justification for the theory's stance on the "proper" relationship between states resource allocation

What is a state? How is a state different than a government?





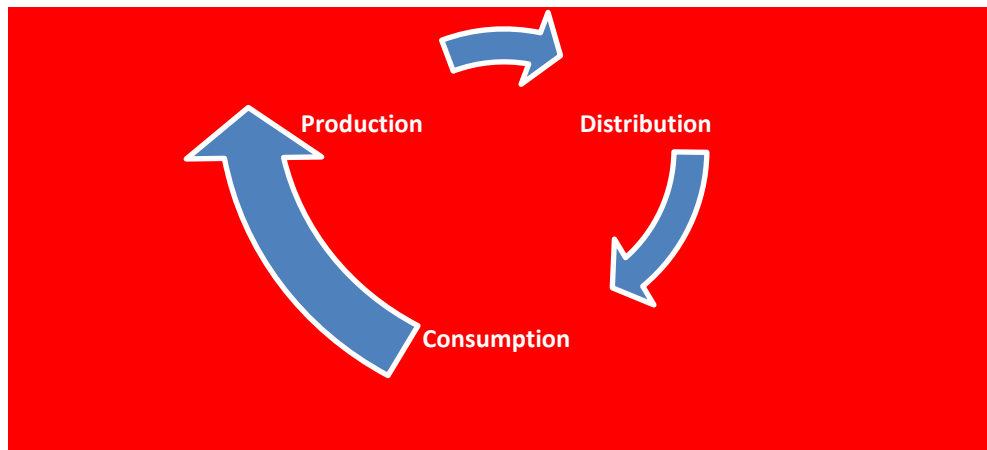
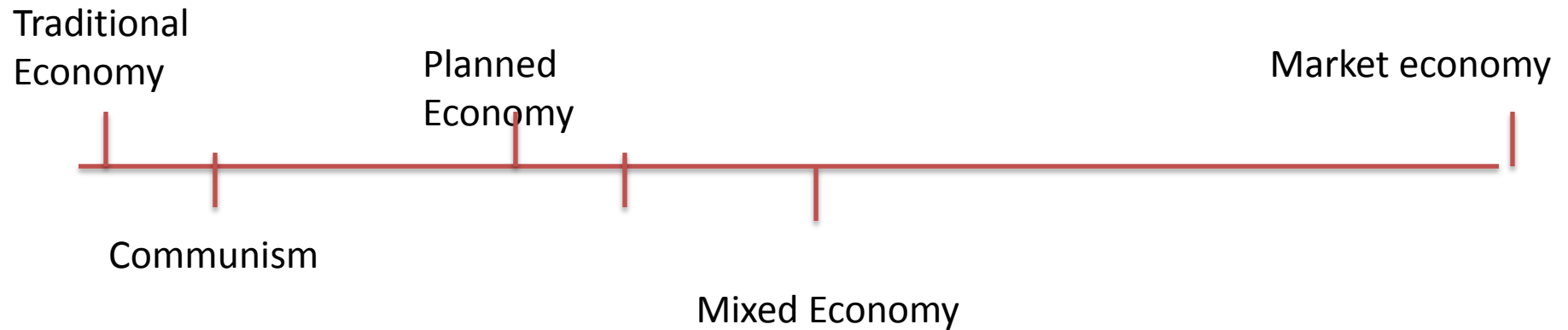
Resource allocation

Assumption: Limited Resources, Unlimited Wants

- **How should resources be allocated?**

States (sovereign institutions that exercise power) decide this based on certain values:

Institutions of Resource Allocation with varying degrees of state intervention



Liberal Theory of Resource Allocation

Assumptions

- Individual is at the center
- Desire for freedom is natural
- Humans are rational
- Humans are self-interested

The model

- The market
- Non-coerced Exchange
- Private Property
- Division of Labor
- Markets clear through supply, demand, and price

Goals and Effects if the model is followed

- Efficiency
- Growth
- Welfare
- Peace

Assumption: Individuals are self interested



- http://www.youtube.com/watch?v=RWsx1X8PV_A&feature=related

How do economic liberals want to limit the state?

- Liberalism is classically defined as an attempt to limit the power of the state for the sake of individual freedom.
- Does this mean they want weak states?
- In fact, they want state power to do a lot of things.
- Liberals aren't opposed to authority, only to certain kinds of authority

What is the role of the state:



Fred Hayek

- To ensure competition in the market?
- Why?
- It's the **most efficient**
- Ensures the **most freedom**
- Any other method the state uses to guide economic activity will create huge problems. (like making certain activities illegal)
- If the state doesn't ensure competition, **monopolies** will develop—undermining freedom

Milton Friedman on the role of the state in the economy

- <http://www.youtube.com/watch?v=0PaN9M4WwHw&feature=related>

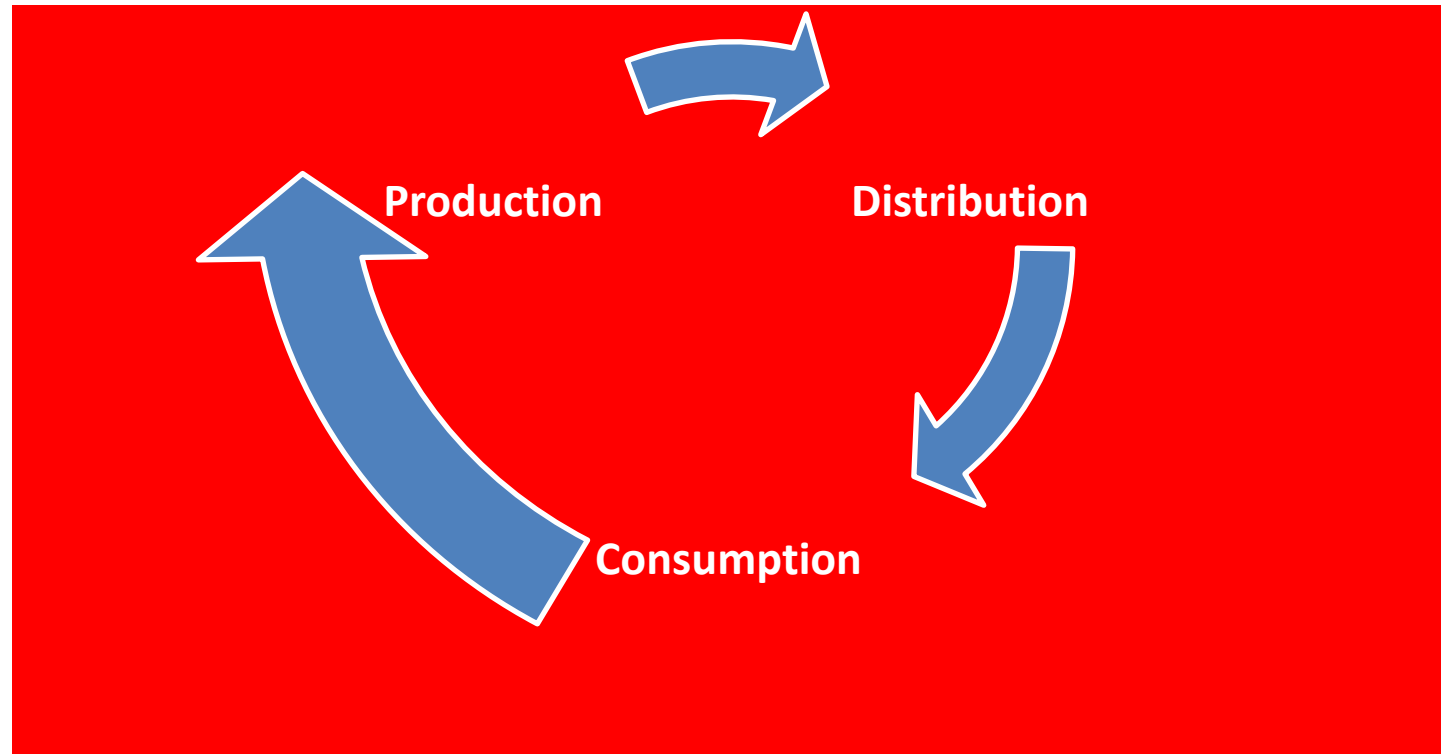


Ismael Roldan

Example: A spontaneous Drug market

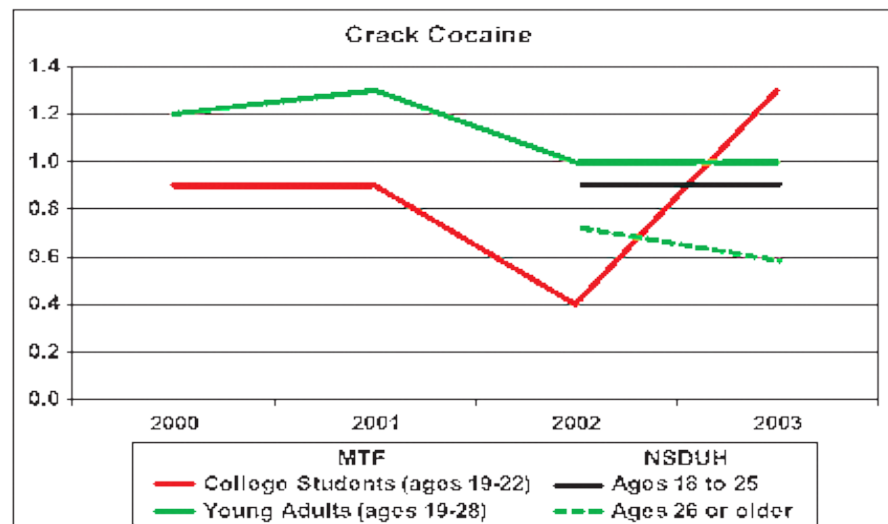
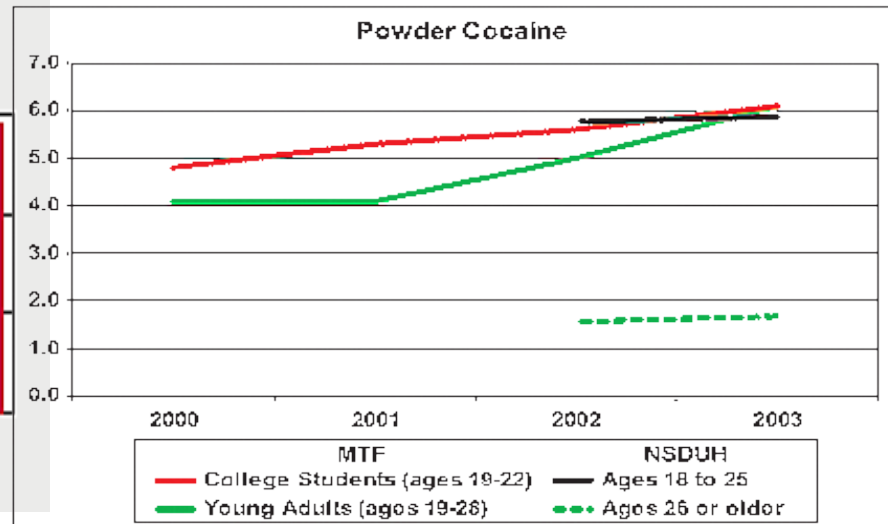
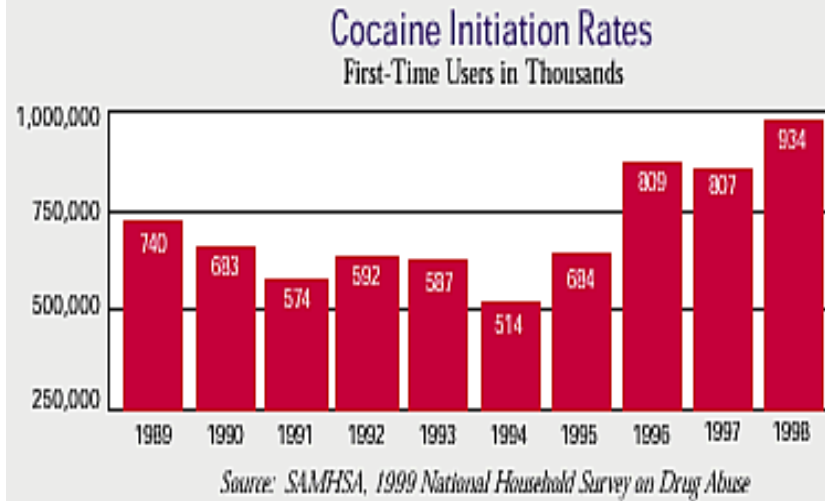


Institutions of Resource Allocation

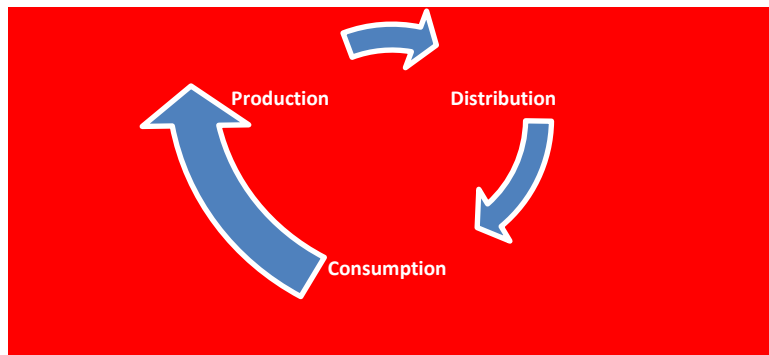


Supply (production) is driven by demand

Demand is High and steady



Supply is actually abundant.....production costs low... processing is easy and cheap



Market is large. 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**

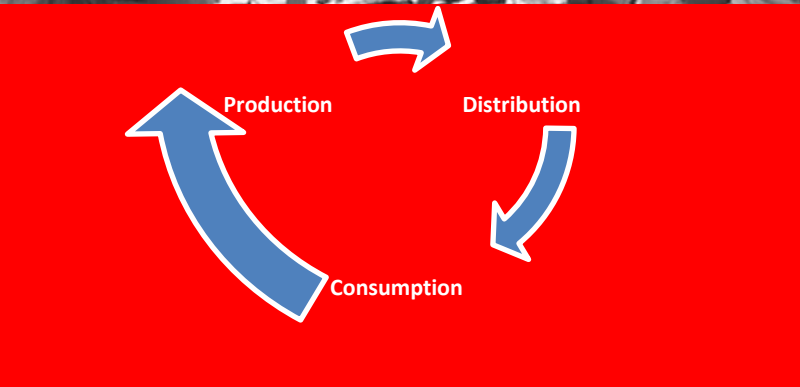
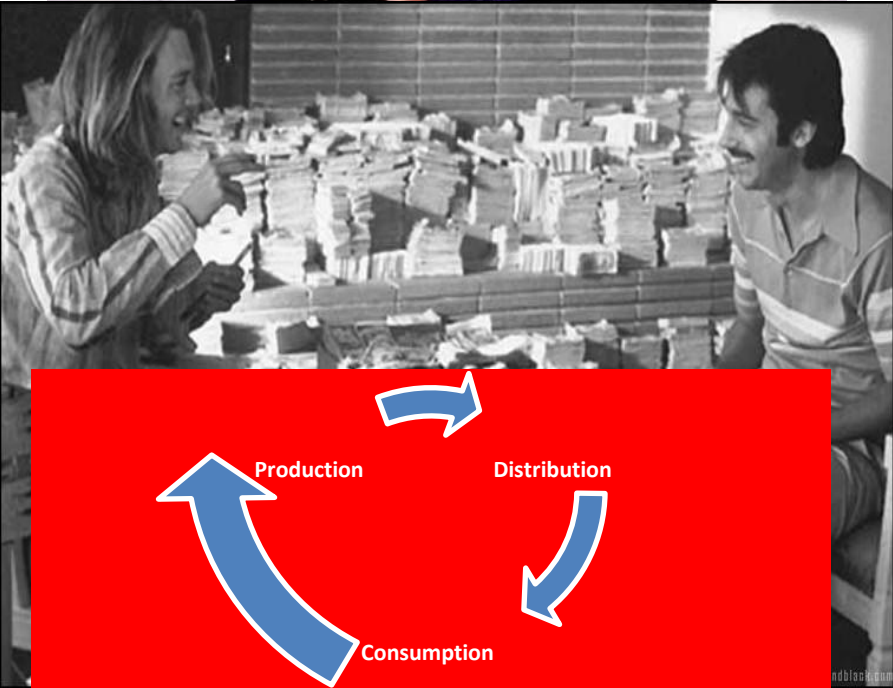
**Livestock: few \$
per acre**

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



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

And rational to sell it.....



So the State does have an important role:

- Limit working hours
- Require sanitation
- Provide social services
- All three fully compatible with competition if applied to all.....
- Main job: “create conditions in which competition will be as effective as possible”



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



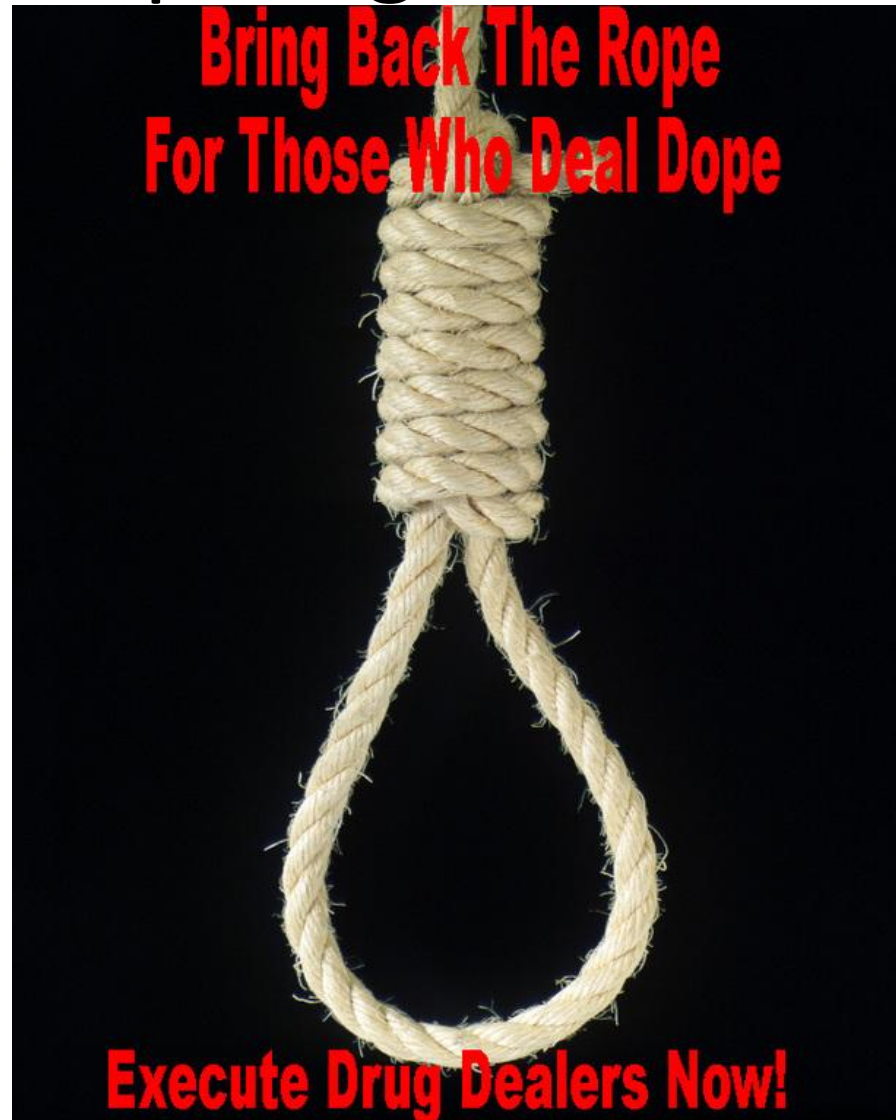
Over 30,000 drug-related deaths in Mexico since 2006



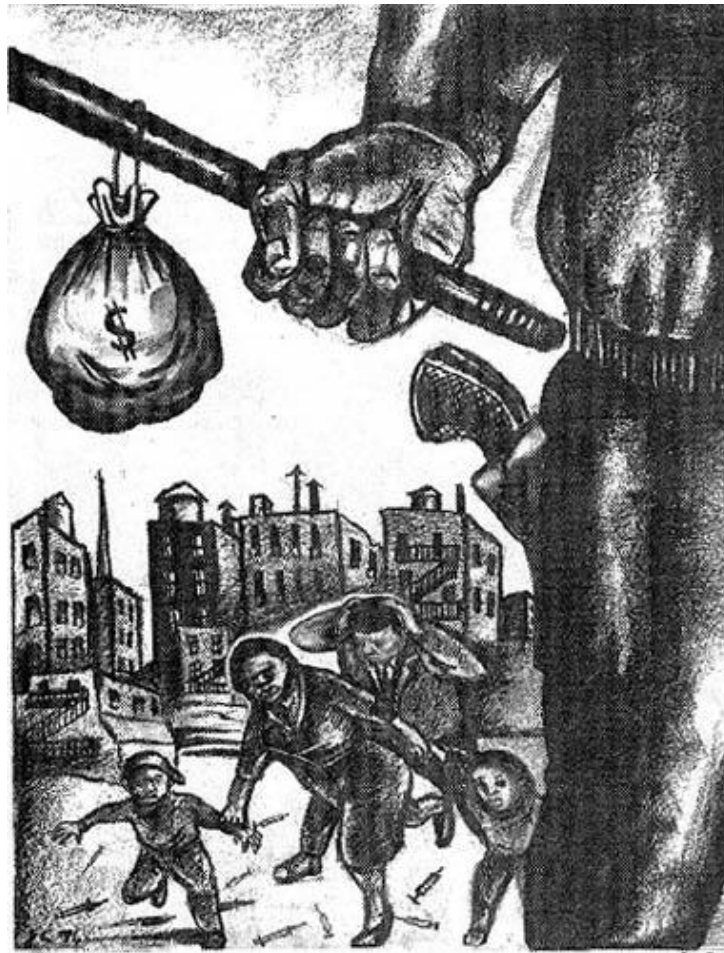
Govt. efforts to make the market illegal means using the military to try to get rid of the market



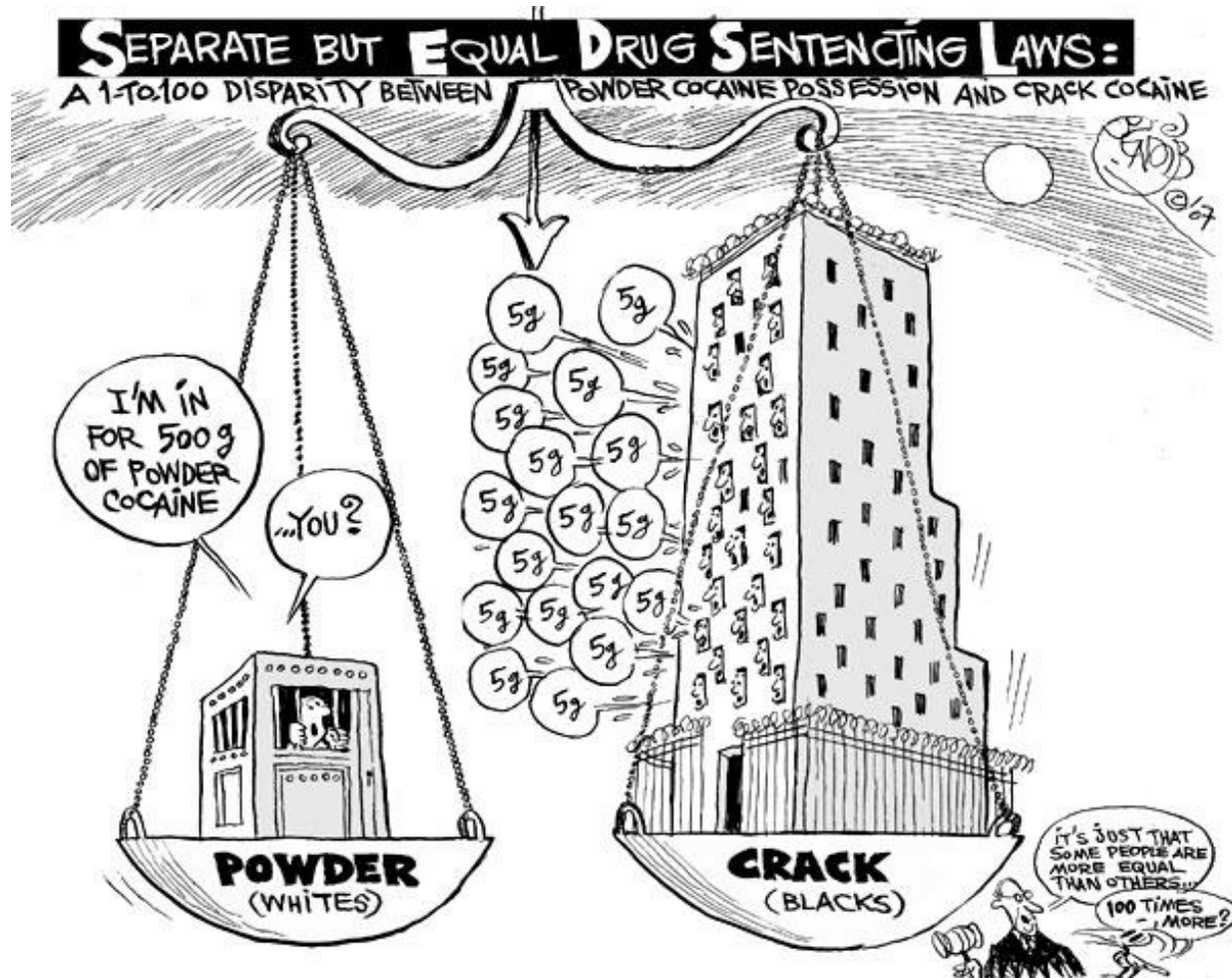
And imposing Harsh Penalties for participating in the market



And fostering corruption.....



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



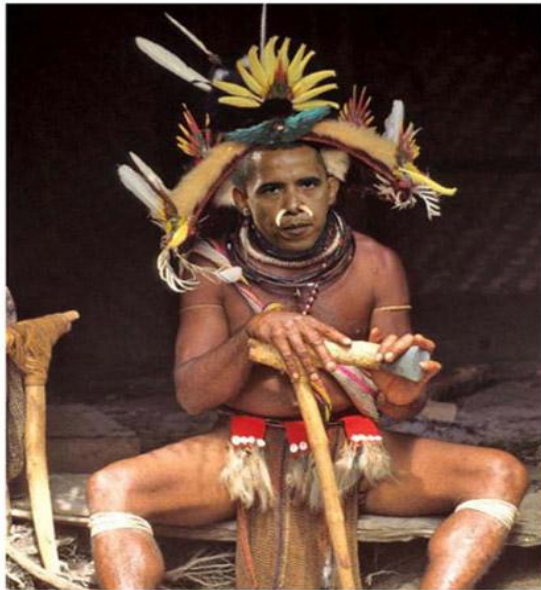
The Economic Liberal believes: The War on Drugs suppresses Freedom...



Summary:

- People make rational choices
- Rational people create spontaneous markets,
- Thus markets are “natural” and should be free
- Free exchange creates “true” prices
- 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

Obama: Why is he thought of as both a Nazi and a Socialist? Is it Heyak's fault?



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SOCIALISM**



**DEMOCRATIC
SOCIALISM**



**MARXIST
SOCIALISM**



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In troubled times, the fearful and naive are always drawn to charismatic radicals.

Role of the State

- Create social trust
- Rule of Law
- Ensure competition except when inefficient (public goods)
- Limit negative externalities
- Critique: issues of basic needs are not addressed by the liberal paradigm—also, there is high demand for basic human needs to be met; calls forth supply but price is too high?
- Liberals see in a bipolar way: markets or no markets