

Economics made Simple

Week 4

Schools of Thought

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Dr. Tom McDonnell
NERI (Nevin Economic Research Institute)
Dublin
Tom.mcdonnell@nerinstitute.net



Research for new economic policies

ECONOMIC DEBATES

Political economy

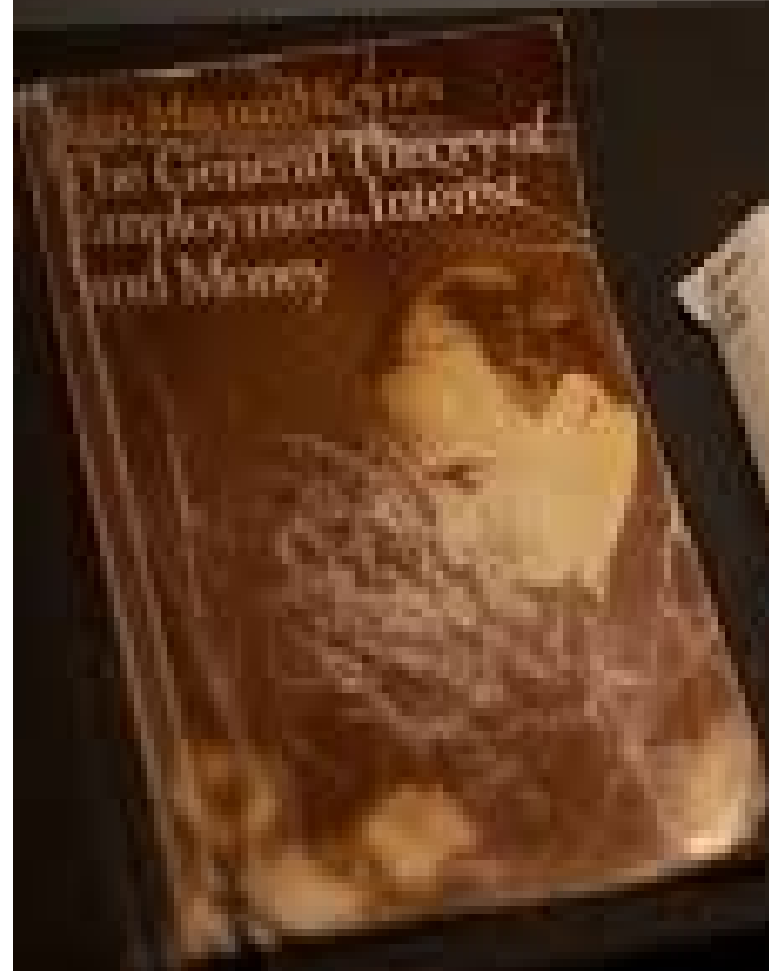
- *The **ideas** of economists and political philosophers, both when they are right and when they are wrong, **are more powerful than is commonly understood**. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist. (John Maynard Keynes, The General Theory of Employment, Interest and Money, 1935)*
- Economic ideologies are themselves phenomenon to explain
- Political economy “interrogates economic doctrines to disclose their sociological and political premises”

Political Economy and the rules of the game

- The need for **economic and social institutions**
 - What are institutions?
 - The rules of the game – often unspoken
- Social institutions **determine how economic and social actors interact** with each other
 - Individuals and society
- **Groups** of individuals **with similar or overlapping goals will pool together** their influence in order to alter the rules of the game
 - As the economy evolves these power blocks will break apart and reform in different manifestations over and over again in a perpetual process
 - They can coalesce in a number of ways e.g. political parties, interest groups, issue based lobbyists
- The relationship between **markets and the State**
 - There are varieties of capitalism
 - Historical development and experience, the institutional architecture, societal pressures and the underlying structure of the economy all determine the form of economic system pursued

Political economy and private prejudices

- *...the private interests and prejudices of particular orders of men...have given occasion to very different theories of political economy...These theories have had a considerable influence, not only upon the opinions of men of learning, but upon the public conduct of princes and sovereign states. (Adam Smith, Wealth of Nations, 1776)*
- Free market laissez-faire
- The economics of control
- “New political economies”
- Economic power blocs and historical path dependency
- Political economy and distributional conflicts
 - Power relationships in resource allocation



Political economy and schools of thought

- **Political economy** draws heavily on economics, political science, law, history and sociology to explain the politico-economic behaviour of a country
- It **can refer to very different schools of thought** e.g.:
 - **Neoclassical** (rational preferences, utility maximisation, perfect information)
 - **Post-Keynesian** (economic cycles, principle of effective demand, full employment)
 - **Marxian** (exploitation, labour theory of value – surplus value, economic crisis)
 - **Austrian** (methodological individualism, free choice, tyranny of the State)
 - **Institutionalist** (rules of the game, bounded rationality, path dependency)
 - **Public choice** (special interests, rent seeking)

Economic Schools of Thought:

H-J Chang, Economics: The User's Guide

Comparing Different Schools of Economics

	CLASSICAL	NEOCCLASSICAL	MARXIST	DEVELOPMENTALIST	AUSTRIAN	SCHUMPETERIAN	KETHESIAN	INSTITUTIONALIST	BEHAVIOURALIST
The economy is made up of...	classes	individuals	classes	no strong view, but more focused on classes	individuals	no particular view	classes	individuals and institutions	individuals, organisations and institutions
Individuals are...	selfish and rational (but rationality is defined in class terms)	selfish and rational	selfish and rational, except for workers fighting for socialism	no strong view	selfish but layered (rational only because of an unquestioning acceptance of tradition)	no strong view, but emphasis on non-rational entrepreneurship	not very rational (driven by habits and animal spirits); ambiguous on selfishness	layered (instinct – habit – belief – reason)	only boundedly rational and layered
The world is...	certain ("iron laws")	certain with calculable risk	certain ("laws of motion")	uncertain, but no strong view	complex and uncertain	no strong view but complex	uncertain	complex and uncertain	complex and uncertain
The most important domain of the economy is...	production	exchange and consumption	production	production	exchange	production	ambiguous, with a minority paying attention to production	no strong view, but puts more emphasis on production than do the Neoclassicals	no strong view, but some bias towards production
Economies change through...	capital accumulation (investment)	individual choices	class struggle, capital accumulation and technological progress	developments in productive capabilities	individual choices, but rooted in tradition	technological innovation	ambiguous, depends on the economist	interaction between individuals and institutions	no strong view
Policy recommendations	free market	free market or interventionism, depending on the economist's view on market failures and government failures	socialist revolution and central planning	temporary government protection and intervention	free market	ambiguous – capitalism is doomed to strophy anyway	active fiscal policy, income redistribution towards the poor	ambiguous, depends on the economist	no strong view, but can be quite accepting of government intervention

Political economy and economic policy

Political economy heavily influences economic policy:

- **Monetary policy**
 - **Money supply and inflation**; Interest rates; Reserve requirements
- **Taxation policy**
 - **Who pays and how much**; Corporation tax and FDI; Tax breaks and tax justice
- **Public spending**
 - **Redistribution**; Merit goods (education, health, housing); State investment
- **Regulatory policy**
 - **Consumer rights**; Privatisation and competition; Sustainability
- **Wage and Incomes policy**
 - **Collective Bargaining**; Wage floors; Pensions
- **Industrial policy**
 - **Regional development**; Mixed economy; Innovation systems;
- **Trade policy**
 - **Protectionism**; Globalisation; Free trade
- **Growth policy**
 - Human capital (e.g. education); Physical Capital (e.g. broadband infrastructure); Productivity (e.g. R&D)

Policy debates

- **economic and political right** argue for a *laissez-faire approach* to the economy on the part of government - governments job is to ensure free and competitive markets
 - The right argue that free markets are the most efficient (least wasteful) way to achieve economic prosperity
- **centre/left** argue that disequilibria can persist for long periods of time (markets don't work!) and that therefore (e.g.) **government intervention** to boost aggregate demand is necessary to bring the economy towards full employment
 - The centre and the left also argue that government intervention is needed in order to achieve certain social goals such as:
 - Full employment
 - poverty reduction,
 - reduced inequality,
 - environmental protection etc.

WHAT IS ECONOMIC JUSTICE?

Economics as 'social' science

- Economics is the study of resource allocation and production under constraint
 - What should be produced?
 - How should it be produced?
 - Who benefits from its production?
- What should we demand from our economy?
 - Different conceptions of economic justice
 - Conservative maxim
 - Liberal maxim
 - Radical maxim

Economic justice:

Conservative maxim

Conservative maxim: *Payment according to the value of one's personal contribution and the contribution of the productive property one owns*

- A fair definition of equity?
 - What about inherited property or property acquired in any way other than through merit (i.e. sacrifice or personal contribution)
 - Historical wealth inequality was often the consequence of unfair advantage – e.g. force of arms, better connections, inside information, luck, willingness to prey on others
- Studies of wealth tend to show that between 60% and 80% of personal wealth comes either from direct inheritance or the income on inherited wealth

Economic justice:

Liberal maxim

Liberal maxim: *Payment according to the value of one's personal contribution only*

- i.e. labour income is ok but not capital income
- Is the genetic lottery any fairer than the inheritance lottery? (what about bad luck?)
- Talent requires training – is the training the sacrifice?
 - Yet training requires multiple inputs – including from the trainer (teacher) and other scarce resources (educational facilities)
- What about inequality of opportunity?

Economic justice:

Radical maxim and Humane maxim

Radical maxim: *Payment according to effort, or the personal sacrifices one makes*

- How do we define or measure personal sacrifices?
 - Longer work hours? Less pleasant work? More dangerous , unhealthy work?
 - Does this mean that a person without sufficient ‘sacrifice’ would be denied access to a costly medical treatment

Humane maxim: *Payment according to need*

- Do we want a just economy or a humane economy?

THE WELFARE STATE

Why not unfettered free markets?

- The **invisible hand** of the market
 - Free markets, free trade, globalisation

.....
- But what about **market failure**?
 - Coordination failures, monopolies, missing markets
- Or **externalities**, **public goods** and **merit goods**
 - Research, defence, education, health
- Or **sustainability**
 - Regulations – Financial markets, environment, consumer protection

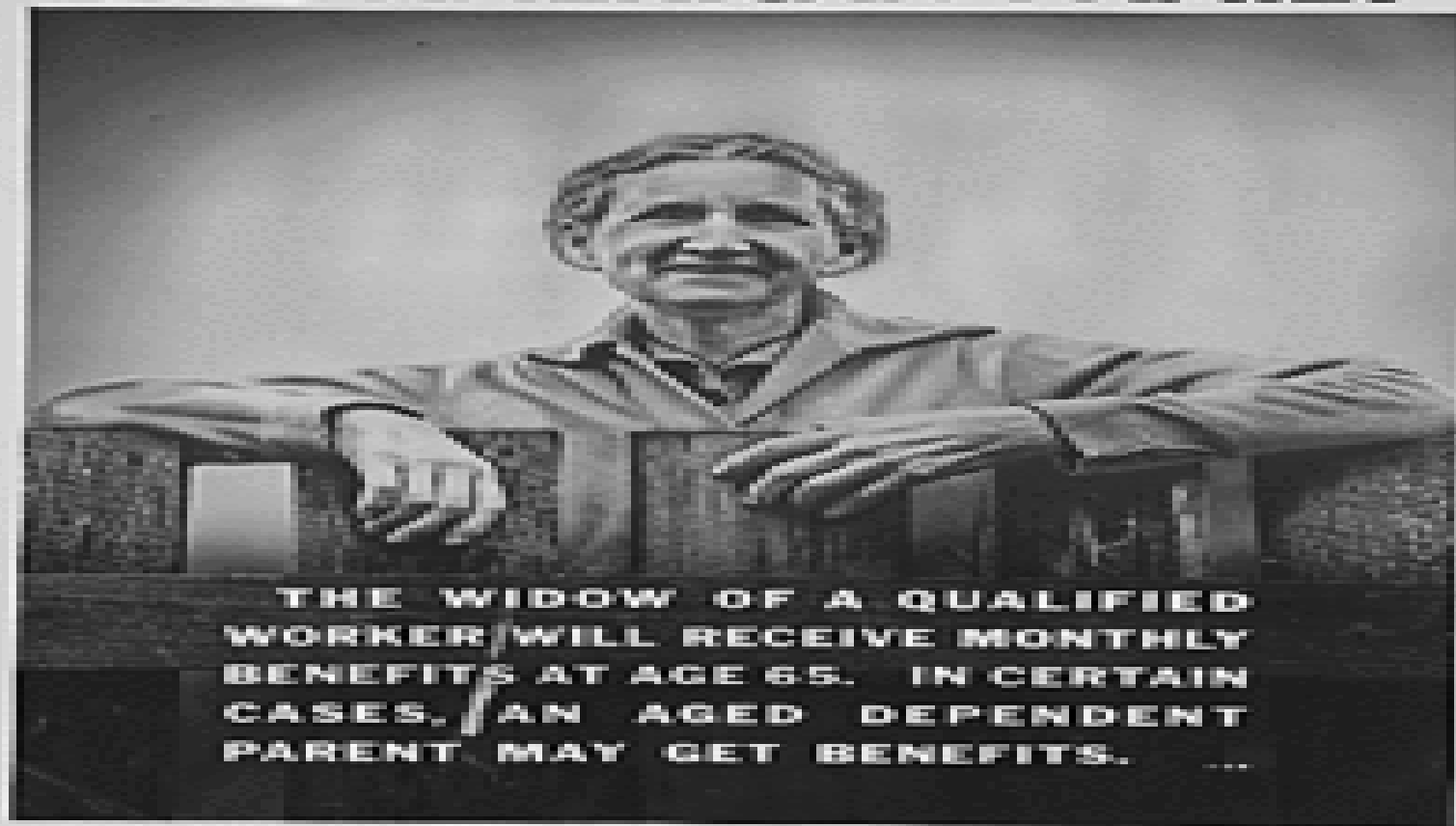
.....
- The economics of equitable cooperation.....**the welfare state**

The idea of the welfare State

- The idea of the welfare state covers a variety of different economic and social organisations
 - Reflects activist state policy to protect and promote the economic and social well-being of its population
 - Redistribution of income and wealth
 - Provision of public services (health, education, housing, public transport)
 - Basic protections e.g. a state provided pension
- The welfare state is funded through redistributive (progressive) taxation

Social security...

MORE SECURITY FOR THE AMERICAN FAMILY



**THE WIDOW OF A QUALIFIED
WORKER WILL RECEIVE MONTHLY
BENEFITS AT AGE 65. IN CERTAIN
CASES, AN AGED DEPENDENT
PARENT MAY GET BENEFITS. ...**

**FOR INFORMATION WRITE OR CALL AT THE NEAREST FIELD OFFICE OF THE
SOCIAL SECURITY BOARD**

Defining the welfare state

- A form of economic and social organisation
 - A system in which the state plays a role in the protection of its citizens
 - Not just physical protection and the maintenance of order, but promotion of the economic and social well-being of its citizens
- The welfare state can be seen as a combination of collectivism, capitalism, social welfare policy and democracy

Origins of the welfare state

- Bismarck's Sozialstatt (1870)
 - Social insurance model
 - Not just poverty relief
- Swedish welfare state (1936)
 - mixed economy based on compromise between trade unions and corporations
 - Strong unions; well funded social insurance system; universal health care
 - Cradle to the grave protection
- Most European and North American countries now contain at least some elements of the welfare state
- Responses to socialism?
 - A middle way between laissez-faire capitalism and communism

Categories of the welfare state

- The welfare states of the late nineteenth and early twentieth century were often enacted by conservatives
 - The creation of the welfare state was seen as a way of defusing socialist and leftist sentiment
- The Beveridge Report (1942) argued that government should provide adequate income, education, healthcare, housing and employment for everyone
 - The National Insurance system
- Types of welfare capitalism
 - **Social-democratic** welfare state (universal benefits)
 - **Christian-democratic** welfare state (insurance system – still allows for social stratification)
 - **Liberal** regime (private provision of services, market dominance, means tested benefits)

The christian-democratic welfare state

- Based on the principle of 'subsidiarity'
 - the idea that a central authority should have a subsidiary function, performing only those tasks which cannot be performed effectively at a more immediate or local level
- Citizens should be immunised from market dependency
 - De-commodification
- Dominance of social insurance schemes (permits a high degree of social stratification)
- Germany, France, Spain, Italy, Belgium, Austria

The liberal welfare state

- Based on the principles of market dominance and private provision
 - Minimal de-commodification
- State should only intervene to provide for basic needs (poverty relief)
 - Means tested benefits
- Social hierarchies are maintained (high social stratification)
- USA, UK?, Japan, Australia, Canada, Switzerland

The Social-democratic welfare state

- Based on the principle of universalism
 - Benefits and services are accessed based on citizenship and are automatic depending on status (e.g. age or employment status)
 - Provides a high degree of personal autonomy (limits reliance on family and the market)
- Denmark, Norway, Sweden, Finland, the Netherlands

Locating the Irish welfare state

- Insurance-based?
- Targeting-based?
- Universalist?
- The Irish welfare state is a hybrid system
 - Ireland uses a mix of means-tested, insurance based and universalist income support and service arrangements
 - A ‘mongrel’ welfare system

Criticisms of the Welfare State

- Criticisms from the Right:
 - Social insurance is counterproductive; welfare makes people 'lazy'
 - Weakens private bonds (e.g. family) and institutions such as churches and charities
 - Creates a self-interested bureaucracy
 - Leads to increased taxation of the wealthy
 - Reduces economic efficiency
 - Are these criticisms fair?
- Criticisms from the Left:
 - Welfare state provisions seen as bribes that do not alter the existing hierarchies
 - Does not transform work practices
 - Undermines transformative change

Conclusions

- Welfare states represent the mixed economy and a compromise between capital and labour
 - Not socialist but not truly capitalist either
- Different principles underpin different welfare states
- All advanced economies are welfare states
 - Some are residual welfare states (e.g. USA)
 - The Nordic countries are at the other extreme