KANDIDAT

10026

PRØVE

POL2012 1 Teorier og modeller i politisk økonomi

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POL 2012: Teorier og modeller i politisk økonomi

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Tilgang til besvarelse: Etter eksamen finn du besvarelsen din i arkivet i Inspera. Merk at det kan ta én virkedag før eventuelle håndtegninger vil være tilgjengelige i arkivet.

1 Del 1

Del 1
*Svar på **ALLE** de følgende spørsmålene (50%):*

Spørsmål 1: Forklar Ricardo's teori om leie.

Spørsmål 2: Modeller og forklar en endring i etterspørsel.

Spørsmål 3: Annta at Italia kan produsere enten 120 tonn oliven eller 7000 liter rødvin, og at Hellas kan produsere enten 80 tonn oliven eller 2000 liter rødvin. Bruk Ricardo's teori om handel til å forklare potensiell handel mellom de to landene.

Spørsmål 4: Forklar Marx's teori om fallende profi

Spørsmål 5: Hva er de vanligste analyseenhetene i den neo-klassiske tradisjonen?

Spørsmål 6: Forklar hvorfor jordreform er et sentralt første steg innen økonomisk utvikling i følge Studwell (2013).

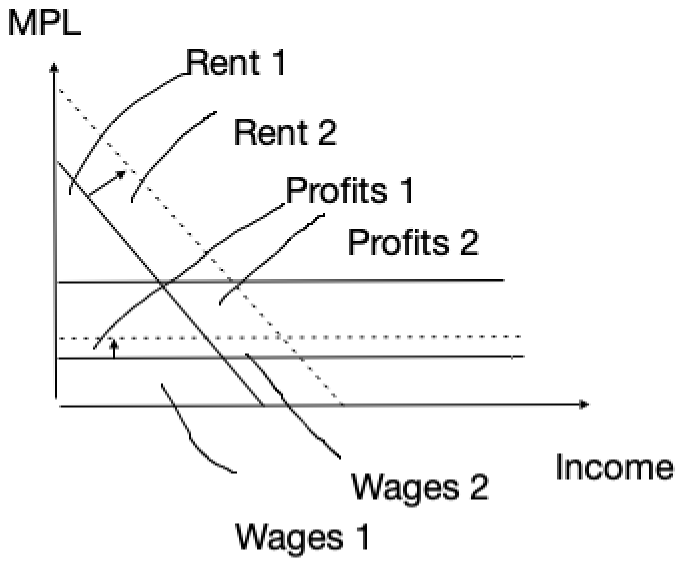
Spørsmål 7: I følge Bates (2008), hva er problemet med det han kaller 'kontrollregimer' ('control regimes')?

Skriv ditt svar her

1: Ricardo's theory of rent

Ricardo, as a classical economist, states that there are three receivers of income in the economy: Workers that receive wages, landowners that receive rent, and capitalists that receive profits.

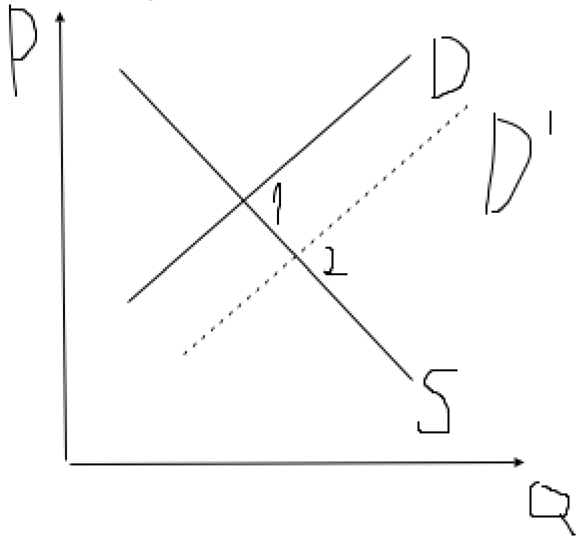
Based on the marginal product of land (MPL), Ricardo formulates a model in which an ever expanding economy will lead to stagnation. This is because the landowners will receive a larger "piece of the cake" than the workers and capitalists, relatively. As the economy expands, workers are also likely to receive a larger proportion in wages, which will take even more of the profit of the capitalists.



Here, the dotted line represents an increase in the economy as a whole (which gives increased income), while the dotted horizontal line represents a higher wage demand from the workers. We see that the landowners' income increases relatively more than the workers wages (okay according to the classical economists, as they only should be paid what is necessary for them to survive), and the capitalists' profits.

Ricardo and the other classicals are convinced that these profits are necessary to develop an economy. Thus, when profits are being eaten up by wages and rent as the economy expands, stagnation will happen.

2: Change in demand



What is illustrated here, is an increase in demand: line *D* shifts to line *D'*. We see that the initial equilibrium is in point 1, where supply meets demand. Then demand increases (meaning that more products, *q*, are demanded at a lower price, *p*), and we see that a new equilibrium is formed in point 2.

At this new equilibrium, suppliers will provide more products at a lower price.

This happens because of the inverse relationship between demand and price, as stated by the law of demand: as the marginal utility of any good or service is declining, consumers will be less and less willing to pay for another unit. This is based on 1) the substitution effect that states that consumers will choose another good or service that can substitute the primary one, and 2) the income effect, that states that a good or service that increase in price will take up more of the total budget of the consumer, making it decrease its demand for that good or service, and goods and services in general.

Finally, this is dependent on the elasticity of demand: if it is inelastic (as necessities), the change in demand is less sensitive from a change in price, and if it is elastic (as luxuries), change in demand is more sensitive from a change in price.

This is all dependent on the assumptions of the neoclassical economists. Simplified, they assume that actors act rational and seek to maximize their own utility, and that everyone has full information and act independently (there is full competition).

3: Ricardo's theory of comparative advantages

What Ricardo is most known for, is his theory of comparative advantages – the classic theory on international trade. His theory states that, given low barriers of trade, countries will be better off by specializing and trading.

In this example, we see that Italy is better at producing both goods – it has the absolute advantage. However, according to Ricardo's theory, trade will make both countries benefit either way. Italy must produce what it is comparatively best at (red wine), and Greece must produce what it is comparatively less worst at (olives). This way, their combined output will be higher than it would have been if they had not traded.

If Italy choose to produce half of each, it will produce 3500 + 60 = 3560 units in total.
If Greece choose to produce half of each, it will produce 1000 + 40 = 1040 units in total.
The total units produced will be 4600.

However, if Italy choose to only produce wine, it will produce 7000 units in total.
If Greece then choose to only produce olives, it will produce 80 units in total.
The total units produced will now be 7080.

If the countries now trade, they will both have a higher total output than they would have had by themselves. *(This can be set up and explained far better and more precise than done in this exam).*

This is Ricardo's argument for free trade and specialization within countries. However, this theory can be criticized: For instance, it does not take transport costs into account, strategic reasons (China produces a lot of the world's antibiotics for instance), or as have become more relevant later on, environmental costs. It also does not take national labour markets into account: Will Italian olive farmers, which after all are better than Greek ones, be very happy about laying off their industry?

4: Marx's theory on the falling rates of profit
Marx states that the marginal productivity of labour is falling – meaning that one more unit of labour added, will add less productivity than the last unit added. This means that there are limits to how much labour one can add in production, and thus the production must be ever more capital intensive. This implies that capitalists will have to add more and more capital into their production, which brings about that the profit from this capital will fall.

According to Marx, this will mean that capitalists engage in a race to the bottom, where many capitalists fail, and others take over. In the end, Marx states that this will lead to the fail of capitalism (along with the disproportionalities within capitalism that cause inertia, and the double role of reducing wages: it will create more profits, but also reduce aggregate demand, and thus lead to stagnation).

5: The unit of analysis in neoclassical economy
In neoclassical political economy, the main units of analysis is individuals and firms.

Individuals are thought to be rational and make value-based decisions, seeking to maximize their own utility. They are also assumed to have full information, and act independently (perfect competition).

This can be scaled up: One can analyze firms, as they are made up of individuals. Further on, the assumptions are assumed to hold on the macro level as well as on the micro level. Thus, the neoclassicals can also analyze the national economy, although the micro level is the main point of interest.

It can be added that several economists, such as Keynes, uses some of the neoclassical framework. He accepts the general equilibrium theory, and bases many of his models on this. As neoclassical political economy is a framework rather than an ideology (for instance, it is far less political than neoliberalism), it can be used as it is by Keynes to also study the macro level.

6: Studwell on Asia
In a developing economy, it is important to note that the vast majority of people are working in the agricultural sector. This implies that agriculture is where one must start to make improvements.

The reason this is so important, is that the national economy only has itself to work with in the beginning. It cannot expect to jump straight into exporting and competing on the international level. The key word here is demand: Once the economy develops into Studwell's "step 2", manufacturing, there must be demanders in the national economy.

Therefore, Studwell argues that the agricultural sector must be structured into so-called highly labour-intensive household farming. This will employ most of the people, which by now is low skilled, and give them a small surplus. Thus, they can be demanders in the coming manufacturing economy.

Studwell states that the Northeast Asian countries managed this, while the Southeast Asian countries did not (within the groups of countries in his analysis). He also compares this to Africa, where many countries jumped straight for the manufacturing part. With low demand in the national economy, and local firms that cannot compete internationally (because there has been no strict export discipline), Studwell states that this will fail.

7: Bates on Africa

Bates lays out the following model with two different outcomes:

0) State predates => citizens take up arms => political disorder

1) State protects => citizens are productive => political order

What decides whether a regime chooses to predate or protect, depends on (1) the income from productive citizens, (2) the rewards from predation, and (3) the leaders' discount rate.

Bates then argues that control regimes will predate on their citizens. There can be various reasons for this, but he states that it will depend on the above (simplified) model. The problem with this, is that it will hinder economic development, as citizens cannot rely on the regime to protect their interests – it will rather prey on them.

Bates discusses many empirical outcomes that he explains by this model. For instance, the liberation many countries had in the 60's meant that leaders very quickly wanted to take control over their natural resources. The well-known resource curse means that the regime to a large extent does not need productive citizens, and predation may be explained by reason (1). Another example may be the 70's oil crisis, where oil prices suddenly went up by a lot, and production became far more expensive (affecting reason (1)). By this time, some citizens had been able to gain more, and the rewards from predation rose (reason (2)). Last, when the USSR backed out of Africa to see to its own problems, the US and many others did so too. This meant that the states had less army backing, and thus had to hold elections. This gave the leaders less time, and so their discount rate fell (reason (3)).

In a control regime that predates, Bates states that citizens will have to either A) choose to be poor, so that there is little to loose, or B) try to gain, and be prepared to protect oneself (for instance by taking up arms). This will lead to nothing but political disorder, according to Bates.

Besvart.

2 Del 2

*Svar på **1** av følgende spørsmål (50%):*

Spørsmål 1: Forklar enten den vellykkede økonomiske utviklingen eller mislykkede økonomiske utviklingen i et valgfritt land, fra et 'evolutionary economics'-perspektiv.

Spørsmål 2: Velg et relevant teoretisk perspektiv å diskuter probelmet med økonomisk ulikhet, samt mulige botemidler.

Spørsmål 3: Diskuter den globale finanskrisen (2008-2009) i lys av en statsgjeldkrise, slik tilfellet var for Hellas og Island.

Skriv ditt svar her

Task 3: Financial crisis and state debt

Firstly, I will do a short and simplified presentation of the financial crisis. Then I will discuss what tools the states had available, before looking at two states, Greece and Iceland, separately. Finally, I will summarize and highlight some different schools of thought.

The 08 financial crisis

The crisis came from the US housing market (although Marxists may want to highlight the problematic capital flows which made capital flow into the US after the '98 Asia crisis). Many individuals were given loans which they did not have enough liquidity to manage. These so-called subprime loans were bundled together (securitiziation), which normally would be okay if they were bundled with good loans, but they were bundled together with each other in so-called CDO's – collateralized debt obligations. These CDO's were then given good credit ratings from the credit agencies, which gave the market the wrong impressions of these financial instruments (institutionalists may point to this as one of the reasons for the crisis).

When these loans defaulted, and people realized that there had been a bubble, it all broke down (neoclassicals could point to this as one of the main problems: the rents should have been higher). This affected a lot of individuals, but we will now discuss the situation in Greece and Iceland. Before that, we must take a look at the tools these states had available.

Stabilizing policies

According to Keynes, the state needs to perform so-called countercyclical policy: fiscal and monetary policies to ensure that the economy performs at its optimal production capacity. This means that there should have been more contractionary policies in place during the boom, and what is most interesting for us – expansionary policies after the crash.

So, Iceland and Greece has two main tools.

1) Fiscal policy

The state regulates the budget deficit. Increasing government spending will stimulate the economy. For instance, building roads leads to more demand in the construction industry. The state must, according to Keynes, be willing to go into debt to create more demand in the economy during a crisis. He even states that it will give more in return than what it costs, as the so-called multiplier effect ensures that an amount spent in the economy will have spillover effects beyond that initial amount.

2) Monetary policy

The central bank sets the rent. Lowering the rent will mean that savings and safe investments are less worth – thus, capital will be placed in projects that will boost the economy (can maybe be compared to the word invented by the Solberg government: "arbeidende kapital / working capital").

The central bank may also choose to do currency maneuvers, as devaluing, but for many states that aim for a stable inflationary target, this is not conventional monetary policy.

However, using these tools is easier said than done, especially for Greece.

Greece

When it comes to fiscal policy, Greece's problem was that it already was in a lot of state debt. Increasing the budget deficit means that the state will have to lend that money from somewhere, usually by selling state obligations. But as Greece is a part of the Eurozone, this is not straightforward. The European Central Bank (ECB) has strict rules for how much loan the states can have compared to their income, and does not approve of Greece's underbudgeting. This means that they cannot build their way out of the crisis, as for instance Norway with its oil fund can do (at least not to the same extent).

The same problem persists regarding the monetary policy: Greece does not have its own central bank, as it is a part of the Eurozone. Thus, it must accept the rent that the ECB sets. The ECB here has two problems: More developed economies with lower debt rates, as Germany, will not want a too low rent. This is because they fear for inflation. For Greece, in deep financial trouble and with a lot of debt, high rents and low inflation will mean that their loans will be even more expensive.

When the state wants to repay its debt, there are two options: 1) conduct strict spending regimes, in order to increase income and repay, or 2) let inflation "eat up" the loan.

This illustrates some of the problem with the Eurozone – the states are in a monetary union, but operate with separate budgets. The ECB must conduct policy that will be right for some countries, and wrong for others.

Keynes would not approve of the strict policies Greece had to conduct: fiscal austerity and too high rents.

Another alternative that Greece could have done, was to leave the Eurozone and devalue. This would be a hard blow for their creditors, but it would effectively reduce the size of their loans. In addition to this, it would have given them more space to conduct their own preferred expansionary fiscal and monetary policies. It is however likely that reintroducing its national currency and ditching the euro would have lead to a lot of economic turmoil of other sorts.

Iceland

Iceland however, chose to devalue. This made their loans more manageable, but it does not mean that Iceland came out of the crisis unharmed.

Devaluing your currency means that it will be relatively less worth to other currencies. It has some nice effects, as reducing what you owe to foreigners, and making exports more worth. But it comes with a backside: Besides the fact that devaluing makes markets have less faith in your currency, and maybe your economy as a whole, devaluing makes imports more expensive. Iceland, being an island, relies heavily on imports. This would give hard blows to their economy for many years to come.

This also laid restrictions to their fiscal policy. As stated above, the state should be willing to go into debt to stimulate the economy with fiscal policies. However, who would want to be the creditor to a state that just devalued? Potential lenders could not be sure that Iceland would devalue once again, affecting their deposits.

Although Iceland was not bound by the ECB, and probably was better off by devaluing (as many argue that Greece should also do, and ditch the euro), they too were hit hard by the financial crisis.

Conclusion

Economists do not agree to what extent state debt is a problem. Keynesians, who have been used for basis of argumentation in this text, could say that state debt in the long run is less of a problem than unemployment and individual economic crisis in the short run ("people need to eat in the short run"). Institutionalists could point to the fact that China owns a lot of state obligations around the world, and what implications that could have, while Marxists might highlight the problematic capital flows that debt brings about. Evolutionists could go to the history books: Do we have an example of what happened last time states had high debts, and what can we do different this time? Neoclassicals may turn to their deductive models, and state that the rents must rise, in order to reduce the lending that countries do (although they would probably realize that for many states, this would not be a smart move, given the high debt rate they are at already – as explained above, this may cause existing loans to be even more expensive).

The fact remains: There is a lot of state debt, and there is no clear answer to whether we should worry or not, and what policy implications it has.

In this text, I have given a short summary of the financial crisis, and what this meant for two highly indebted nations – Iceland and Greece. They were both hit hard, but they dealt with it in different ways. Greece, to a large extent, had its hands tied by the Western European countries and the ECB, and could not perform the monetary maneuvers many would have prescribed. This means that the country, to this day, lives under a rather strict regime – probably too strict, according to Keynes and followers. Iceland had more tools available, and chose to devalue. However, the negative sides of devaluation made the country suffer hard from the financial crisis as well, and made it difficult for the country to conduct necessary fiscal policies.

Besvart.