

# **FACULTY OF ECONOMICS STUDY AIDS 2019**

ECT1 Paper 4 Political and Social Aspects of Economics
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The Faculty Board has agreed to release outline solutions to the 2019 examinations as a study aid for exam revision. They are abridged solutions, and not 'definitive', and should therefore not be considered as an exemplar for 'complete' answers.

Note that the Faculty will not respond to any queries regarding these solutions.

1 Compare the economic policies and the economic performances between the so-called 'golden age of capitalism' and the subsequent 'age of neo-liberalism' in the advanced capitalist economies. What does this exercise tell you about the role of the state in the economy?

(a) During the so-called 'golden age of capitalism', between the end of the Second World War and the mid-1970s, there was a lot of state intervention in the advanced capitalist economies – strong financial regulations, activist industrial policy, restrictions on international trade and investments, expansion of the welfare state, and restrictions on large enterprises to protect the economically weak. In many, although not all, of them, state ownership of enterprises was extended and active fiscal policy in the Keynesian mould was practiced. Superior answers may also note that there were international differences in terms of policy combinations.

In the early 1980s, the so-called age of neo-liberalism began. All advanced capitalist countries scaled down industrial policy and privatised state-owned enterprises. Many created politically independent agencies in certain policy areas – the independent central bank, utility regulators. Most of them accepted higher inequalities by abolishing those regulations that protect the economically weak, while some (although not all) of them also made their welfare state less redistributive. The more 'Keynesian' countries (the US and the UK) abandoned Keynesian macroeconomic policies during this period. Superior answers may note that, despite the general reduction in the role of the state, the welfare state kept expanding in most countries.

(b) The neo-liberal era has had better record in terms of inflation, but has done far less well in all other aspects – income distribution, unemployment, economic growth, and financial stability. I don't expect the students to be able to cite exact numbers here, but they should be able to mention things like: economic growth was much lower in the latter period (from around 3% to 1.5% in per capita terms); inequality has increased in most countries; unemployment is much higher now (used to be below 2% in many economies in the 'golden age'); there have been dozens of major financial crises in the latter period, while the former had hardly any.

(c) From the above, we can certainly conclude that the neo-liberal approach to the role of the state – that is, the smaller and the less discretionary the role is, the better it is – is not borne out by evidence. It may be reasonable to go one step further and say that the more interventionist policies of the 'golden age' are superior to neo-liberal policies. Superior answers, however, would qualify such conclusion by stating that there were factors other than state intervention that may partly explain the superior economic performance of the 'golden

age' (e.g., pent-up demand from the WWII period, catch-up with the US by the European countries and Japan).

2 Discuss different types of power that matter in economic analysis.

There is of course the notion of market power, coming from monopolistic/oligopolistic and monopsonic/oligopsonic positions and this is already well analysed in economics.

However, there are also other types of power that is rarely discussed in economics.

The first is structural power coming from imbalances in income and wealth. Those with superior income and wealth has 'structural' power over those who do not in the sense that the lack of independent means of subsistence makes the latter voluntarily 'choose' to enter contracts that damage them in the long run (e.g., dangerous or degrading employment).

The second is the power to discriminate. Employers discriminating against certain groups (e.g., women, ethnic minorities) is not a matter of 'preference', as some economists argue, but an exercise of power, if the groups that are discriminated against are socially defined and the act of discrimination is at least implicitly supported and often actively promoted by the dominant, more powerful, groups in the society.

Third, there is the power to dictate things within organisations. Most economic activities are organised not through markets but through organisations, such as corporations and the government. These organisations are based on power relationships within them, in which those higher up the hierarchy have the power to dictate those lower down what to do.

Fourth, there is the power to make people think what you want them to think. Those who have money have influenced people's 'preferences' (and not just their 'behaviours') through advertising, funding of research, influencing of academic research or educational curriculum.

Better answers will provide some concrete examples of these types of power. The best ones will provide some theoretical insights behind the importance of different types of power in economic analysis.

3 "The consensus in post-World War 2 British politics occurred out of necessity rather than as the result of ideological beliefs". Discuss.

The adoption of the National Insurance Act and National Health Service Act of 1946 by the subsequent Conservative governments was crucial in completing the welfare state. Churchill had been a significant social reformer before and after World War 1 and thus had contributed to the development of the welfare state prior to Clement Attlee. Although Churchill opposed nationalisation in principle, MacMillan and other leading Tories embraced it. Keynesian economic theory was the dominant economic paradigm and so had to be adopted by both Labour and Conservative governments. The Foreign and Colonial policies were set prior to Attlee (partially by Churchill) and the Labour government was obliged by electoral opinion to follow these (in part). Attlee started the atomic bomb programme and the Conservatives continued it.

4 “Tony Blair and his New Labour government largely accepted the policies of Margaret Thatcher’s Conservative government”. Discuss.

Neoliberalism created a transformation. Thatcher largely maintained the non-economic policies of her predecessors. Low direct taxation was continued by New Labour from Thatcher. The privately owned economy was continued. The constraints on the trades unions were continued. The tax burden (stealth taxes) was increased: a new policy. Government expenditure on the NHS and state education grew as deliberate policies: a socialist informed policy. The industrial economy was reregulated: a socialist informed policy. The neo-conservative wars in Iraq and Afghanistan were a new phenomenon in the post-colonial era.

5 To what extent was the Great Recession of 2008 different from other economic failures Britain endured since 1945?

The productive efficiency of the economy at the micro-level was deficient post-1945 compared to the USA, West Germany, & Japan. The application of fiscal demand management increased inflation and tended to create trade deficits which reduced industrial competitiveness. Friedman argued that the application of fiscal demand management created the very stagflation which Keynesian theory could neither explain nor yield a policy prescription to resolve. State planning failed to correct the deficiency in productive efficiency. Supply-side reform subsequently partially corrected the deficiency in productive efficiency.

A countercyclical fiscal expansion to address the 2008 Recession was constrained due to the already expansionary fiscal stance prior to the Recession. Monetary policy has no such constraint but the effects of QE are themselves limited in expanding the economy. Governments can (and do) implement increased regulation of the commercial banking sector after economic shocks, but this reduces economic growth.

6 (a) Outline a model which shows how human capital affects economic growth.

- (b) If we wish to target educational institutions in order to reduce poverty, then how important is the role of school quality?

Should present the model of human capital and economic development outlined in lectures. Should then discuss the importance of educational institutions, distinguishing between the roles of school quantity and school quality. Could cite studies on teacher truancy in India, Duflo Indonesian schools and Bedi and Edwards in the Honduras.

- 7 (a) How do political institutions affect economic growth? In this context, does democracy ensure higher growth?  
(b) Evaluate the claim that political institutions matter more for economic development than human capital.

Needs to discuss the role of political institutions – democracy, autocracy and how they affect governance. Role of the state and where political institutions are important. Needs also to discuss the Acemoglu, Johnson and Robinson result with the instrument of European settler mortality and the Glaeser argument that human capital is more important. Should express a view on the ‘institutions versus human capital affects growth more’ debate.