

# FACULTY OF ECONOMICS STUDY AIDS 2017

ECT1 Paper 4 Political and Social Aspects of Economics
--

The Faculty Board has agreed to release outline solutions to the 2017 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.

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

1. The international differences in the pattern of state intervention suggest that there is more than one way of combining the market and the state.' Discuss with reference to the (historical and/or contemporary) experiences of the advanced capitalist economies.

In the early days of capitalism, all of today's advanced economies were rather similar to each other because they all had an economy that was very under-taxed and under-regulated by today's standards. However, things started changing from the 1930s, when a number of countries introduced new regulatory measures and expanded the welfare state.

During the so-called 'Golden Age of Capitalism', between the end of the Second World War and the mid-1970s, state intervention vastly increased and the differences between advanced capitalist countries grew, with various countries adopting very distinctive approaches to state intervention.

These differences have been reduced in the so-called age of neo-liberalism since the 1980s. During this period, all advanced capitalist countries scaled down industrial policy and privatised their state-owned enterprises. However, the international differences still remain and it is still possible to talk of different types of capitalism.

The upshot is that there have been different mixtures of the market and the state across history and across countries.

2. The government failure approach argues for the minimization of the influence of politics in the running of the economy. Why does it do that? What are the merits and the shortcomings of this argument for 'de-politicisation'?

The government failure approach argues that self-seeking by those who operate in the public realm (e.g., politicians, bureaucrats, interest groups) will result in the adoption of policies that pander to the interests of those who can influence the policy decision-making process, rather than of policies that improve social welfare.

The solution offered is that the making of economic policy should be 'de-politicised'. First, the scope of the government itself should be reduced through spending (and tax) cuts, privatisation, and de-regulation. Second, as many of the remaining functions as possible should be relegated to politically-independent agencies (e.g., independent central bank). Third, those few functions that still remain in the hands of the elected politicians – such as decisions about tax and spending – need to be subject to rigid rules that minimise policy discretion (e.g., ceilings on budget deficit or on public debt).

The government failure approach offers a much more realistic view of how politics influences the management of the economy than does the market failure approach. However, it has limitations. First, this approach is based on simplistic assumptions about human motivations and behavior. Second, it puts excessive trusts on certain types of public officials (e.g., central bankers, utility regulators) while excessively mistrusting other officials (e.g., elected politicians, officials in government ministries).

3. 'No system of economic governance in the European Union is sustainable without full fiscal union.' Discuss.

- Given the confederal structure of the EU, no system for the compliance of member states to given rules is enforceable.
  - Fiscal union is required for a sustainable system of economics governance but this is prohibited because of political opposition.
  - The wage-price adjustment mechanism will not compensate for national disparities of productive efficiency within the Eurozone as this mechanism is too inefficient.
  - A United States of Europe with federal tax raising powers is the only sustainable system in the long-run.
4. To what extent was a new political and economic settlement established in post-World War 2 Britain?
- 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 principal, 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.
  - Attlee started the atomic bomb programme and the Conservatives continued it.
5. 'Margaret Thatcher's Conservative government transformed British politics, however the subsequent New Labour government added virtually nothing new, but largely continued Thatcher's policies.' Discuss.
- Neoliberalism created a transformation.
  - Thatcher largely maintained non-economic policies.
  - 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.
6. 'The use of monetary and fiscal policies was not sufficient to address the Great Recession of 2008, nor was it sufficient to address any of Britain's other major economic difficulties since 1945'. Discuss.

- 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, both of 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
7. Needs to discuss evolution of political institutions (North etc), relationship with democracy, autocracy, and illustrate that the evidence is mixed. Then the debate between Acemoglu, Johnson and Robinson vs. Glaeser on whether institutions or human capital matter more for growth. Can discuss European settler mortality as well. Decide that human capital matters more, but that both might be crucial for economic growth.
  8. Non-rival and non-excludable. Needs to discuss externalities, free-riding and prisoners dilemma. Pasture lands and the tragedy of the commons could be one example; or education/health. Institutions overcome collective action problems. The Olson paradox is that smaller groups coordinate better. Evidence from India. Afghanistan and the US illustrates how governments allocate public goods, and the controversial finding that more ethnic diversity causes lower spending on public goods.

**END OF PAPER**