

Economics Module

Lecture 2

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Marxian Economics

- Analytical framework derived from Marx's own work in the magisterial 3 volume 'Capital' (1867 to 1894) and carried forward by other economists over the 20th century and beyond. Essentially a theory of capitalist dynamics
- Part of the classical economic paradigm(class based social analysis with a focus on the production process) but distinct in its fundamental criticism of the same
- Analytical building blocks: forces of production(technology, machines and labour power) and relations of production (property rights, employment relationship and division of labour)
- Labour theory of value as the guiding principle of economic valuation and surplus value appropriated by capitalists as the source of profits
- Marxian economic ideas were put in use in the Soviet economy (often in a mechanical way) but they also developed in Western academia although always at the margins.

Keynesian Economics

- Named after the British economist John Maynard Keynes
- The key ideas of Keynesian economics are elaborated in Keynes's book 'General Theory of Employment, Interest and Money' (1936) and were based on the experience of the Great Depression (late 1920s- early 1930s) in the advanced capitalist world
- Keynesian theory has been foundational in developing the field of macroeconomics and remained dominant till the 1960s
- Main tenets: The role of uncertainty in determining investments, the possibility of demand deficiency in the economy leading to significant unemployment
- Can be seen as a rejection of Smith's understanding of the market system as a self-equilibrating mechanism
- The main policy prescription from Keynesian theory is the necessary role of governments in boosting demand through public investment

Institutional Economics

- A line of economic thinking that lays precedence on social norms or institutions in determining economic outcomes
- Original ideas started in the USA in late 19th century and was an active line of economic research till the 1930s
- Major contributors: Thorstein Veblen, John Commons
- Criticism- lack of analytical rigour and dependence on descriptive material
- New Institutional Economics emerged in 1980s with the work of Joseph Stiglitz (and others) where the structure of neoclassical economics was modified to account for institutional factors which impacted economic transactions
- Focus on private property rights as the main institution
- Institution here is defined as the 'rules of the game' i.e. rules that regulate economic exchange through the market system

Behavioural Economics

- Take into account human behaviour influencing economic decisions
- Modification of Neoclassical school that human beings act rationally and selfishly always
- “The Behaviouralist school is so called because it tries to model human behaviours as they actually are, rejecting the dominant Neoclassical assumption that human beings always behave in a rational and selfish way.” (Chang)
- Pioneering scholar: Herbert Simon
- The concept of ‘bounded rationality’- rational decision making within the limits of information deficiency and computational constraints faced by the human mind
- More recently behavioural economics has extended to experimental verification of human behavioural patterns- randomized controlled trials

Readings for economic measures

- Tim Callen (2017) Gross Domestic Product: An Economy's All
- Diane Coyle (2017) Rethinking GDP.

Widely used economic measures

- Gross Domestic Product: The monetary value of all final goods and services in an economy within a year/quarter
- Adding the value of all goods produced will lead to multiple counting
- Alternative method is to aggregate the value added at each stage of production
- A third method to arrive at GDP is to add up incomes received by all inputs of production – wages, rents, profits and interests
- GDP per capita is commonly used as a measure of welfare for a country
- Growth rates of GDP are also widely used as an index of economic performance (China, India as vibrant high growth economies as against other stagnant, low growth countries)

Comparing GDP across time and space

- Economic growth takes into account change in 'real' GDP i.e. accounting for change in prices.
- Across time comparison of GDP has to be made on the basis GDP deflated by price index.
- Comparing GDP across countries
 - converting GDP figures to common currency (e.g. convert INR to USD)
 - 5000 INR is \$ 62.5
 - But purchasing power of a dollar is different in the US compared to Rs 80 in India
 - For meaningful comparison, a purchasing power parity(PPP) adjustment needs to be made
 - Typically, a poorer country like India will have a higher PPP adjusted GDP compared to a non-adjusted one.

Limitations of GDP as a measure of welfare

- It is mostly limited to marketed goods and services – household work mostly performed by women is not included
- Most of informal and illegal activities are not captured
- GDP can be increased through spending on war and conflict
- It does not take into account resource depletion and environmental degradation
- GDP per capita is an average measure and like any other measure of central tendency it ignores distribution (inequality is not captured at all)

Employment and unemployment

- Employment is considered another key indicator of macroeconomic health of a country
- Having access to gainful employment is critical for ensuring a decent quality of life for most people
- The employment situation is often tracked through unemployment rate
- Unemployment rate- the percentage of labour force actively looking for employment but not getting it at any given time.
- Some unemployment (3-4 %) is common across countries even when the economy is functioning well
- A higher unemployment rate implies an economic crisis or a recession.
- However, unemployment rate may not be a good indicator of economic distress in a poor country. Why?

Inflation and its relationship with unemployment

- Phenomenon of sustained increase in general price levels. Typically measured using general price index or consumer price index with a specific base year.
- A trade-off between inflation and unemployment was first identified by A. W. Phillips leading to the so-called (negatively sloped) Phillips curve
- The possible reason for this trade-off ?
- Policy implication was critical- targeting either high inflation or high unemployment and not both simultaneously
- However, the Phillips curve wisdom had been challenged repeatedly with situations of 'stagflation' i.e. economic stagnation or even recession in conjunction with high inflation.
- The current juncture in the global economy

Fiscal deficit and its role in macroeconomics

- Like any budget, government budget also has an income and an expenditure side
- Broadly, fiscal deficit is a measure of the excess of government spending over income (see different heads on each side in the next slide)
- Typically fiscal deficit is measured as a % of GDP and fiscal austerity implies have a strict limit on this percentage
- Is spending more than income a sustainable policy alternative for governments
- The dominant neoclassical position is no. Growing fiscal deficit leads to inflation and more generally into economic instability
- The Keynesian position is yes, especially if government spending is used as investment and job creation
- The New Deal as a means of overcoming the Great Depression

	Receipts	Expenditure
	1. Tax Revenue (Income, Customs, VAT)	4. Tax shared with state governments
	2. Non-tax revenue (dividends, charges, fees)	5. Salaries and materials on all government programmes (health, education, irrigation – and defence)
	3. Interest received on loans given	6. Interest paid on loans
Revenue Deficit/Surplus (Difference)	Difference between revenue receipts and expenditure	
Capital Account		
	7. Loans Repaid by states, PSUs	10. Grants to local governments
	8. Sale of Assets	11. Investment in assets, PSUs
	9. <i>Loans from market</i>	
FISCAL DEFICIT	Difference between total receipts and total expenditure (other than item 9)	