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Introduction & Understanding the economic system

| Key Concepts | Elaboration, examples |
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| Different schools of economic thought | <ul style="list-style-type: none"> - conflicting views of which problems important to study, what are the causes of economic problems and what are the best solutions for those problems |
| How economic issues impact society | <ul style="list-style-type: none"> e.g. defence spending - in the US, a huge part of the national economy is directed towards military production - therefore a war in Iraq can determine whether someone has a job in the US - lack of wars impacts on unemployment, standard of living, government spending on unemployment - local economy of state in which war is being waged is skewed towards meeting demands of wartime, not the people |
| Transnational corporations can monopolize the unemployment and production outcomes of a country, affecting economic patterns with their decisions | <ul style="list-style-type: none"> e.g. McDonalds potato production - McDonalds needs a particular type of fries always to the same standard of production - in Tasmania farmers who could not afford to expand their farms enough to grow the potatoes that McDonalds wanted were forced out of business |
| Governments may provide assistance to struggling companies on which their economy relies | <ul style="list-style-type: none"> e.g. Qantas (founded 1920) - privatised by federal government in 1990s, restrictions placed on foreign ownership - Qantas reported a huge loss of profit in 2014 - as result, federal government agreed to have the rules for foreign ownership removed e.g. Cadbury given \$16 million in 2014 to keep production going, without it would have had to close However, Ford and Holden have now stopped receiving government assistance and now have to shut down |
| Environmental, societal and economic influences of one sector of economy may negatively influence another | <ul style="list-style-type: none"> e.g. bees - pesticides used for agricultural production affect bee populations, older bees dying more quickly - huge implication for food production (honey farmers) e.g. Deep Water Horizon - oil tanker spill in Gulf of Mexico 2010 - 5 million barrels of oil - owned by BP, value of assets greater than national product of some countries, uses environment to extract fuels for energy |

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| | <ul style="list-style-type: none"> - number of winners and losers, P still in business, CEO lost role, marine life of Gulf of Mexico will never be the same, those depending on it on livelihood (fishing, tourism) lose out <p>e.g. fishing trawlers</p> <ul style="list-style-type: none"> - supertrawlers have giant nets to scoop up mass amounts of fish - local, small-scale fishermen can't compete - hurt other forms of marine wildlife |
| <p>How and why study political economy</p> | <ul style="list-style-type: none"> - to understand the nature of reality by analysing the connections between economic problems, social structures and political processes - some economists take economy out of society and then seek to explain reality through that, - non-mainstream approach takes into account societal, political, ideological, moral factors - different schools of economic thought dominant through history, allows us to see different approaches to economic problems - schools include Classical political economy, Marxist economics, institutional economics and Keynesian economics (emphasised role of government in creating employment), neo-classic economy (markets unrestricted by government activity) - different schools have distinct values, approaches, methodology <p>5 basic political economic questions</p> <ol style="list-style-type: none"> 1. What is happening? 2. Why? 3. Who gains and loses? 4. Does it matter? 5. If so, what can be done and by whom <ul style="list-style-type: none"> - discipline of economics is also about whether the workings of the economy are good or as and how they might be improved |
| <p>The social relationships define the economic system</p> | <ul style="list-style-type: none"> - Foremost function of economic systems is providing for human needs, determines what work is done, how it is done, who does it, who gets the output of that work - all economic systems are geared towards producing the goods that support human life - Economic systems are SOCIAL RELATIONSHIPS between people - The social relationships define the economic system - Economic relationships may be direct, local or global |
| <p>Economy-society relationships</p> | <ol style="list-style-type: none"> 1. The environment <ul style="list-style-type: none"> - all economic activity takes place within the environment - conversion, extraction of natural resources (e.g. its impact on natural parks) - processes may be restorative or damaging 2. Markets <ul style="list-style-type: none"> - where exchange of goods and services occurs, you are engaged in the markets all the time - impose discipline on participants (rules for participation) |

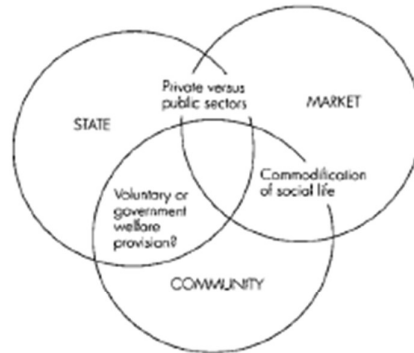
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| | <ul style="list-style-type: none"> - can't solve all economic problems (e.g. in the housing market some participants have far less purchasing power and sometimes markets can't provide particular goods due to interruptions to supply like natural disasters) - markets can't operate without certain structures or underpinnings (rules, property rights and contracts) <p>3. The State</p> <ul style="list-style-type: none"> - direct and indirect economic roles determined by political decisions - government enterprises provide services (e.g. Australia Post, some electricity provision) - raising taxes, government expenditure, impacts on employment, companies <p>4. Class</p> <ul style="list-style-type: none"> - capital (owners of the means of production) and labour - sharp differences in income, wealth, power, social status - relationship can be marked by conflict, cooperation or compromise <p>5. Gender and ethnicity</p> <ul style="list-style-type: none"> - division of labour from discrimination and institutions (e.g. women perform caring roles) <p>6. Social Capital</p> <ul style="list-style-type: none"> - networks of social relationships fostering social cohesion and trust - cultural attitudes to things like religion, marriage, sport, culture - broken down during disruptions like war <p>7. Ideology</p> <ul style="list-style-type: none"> - beliefs that shape behaviour to support prevailing arrangements in the previous dimensions (e.g. consumerist values gear the economic system to produce more and more goods) (e.g. attitudes to women in the workplace) |
| Evaluating economic performance | <p>Efficiency</p> <ul style="list-style-type: none"> - avoidance of waste - production of useful goods and services (difference between needs and wants) - not leaving resources unused <p>Equity</p> <ul style="list-style-type: none"> - equality of economic outcomes and opportunities - impacts of economic events felt equally across society <p>Sustainability</p> |

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| | <ul style="list-style-type: none"> - reproduction of the economic system, is it capable of sustaining itself <p>Social objectives</p> <ul style="list-style-type: none"> - does the system serve society well - importance of social goals and how can we measure them - conventional measure - GDP (total market value of all goods and services), if greater than previous year then economy has grown |
| <p>Problems with GDP as a measure of well being</p> | <ul style="list-style-type: none"> - things sold for monetary value may not improve well-being - many activities not included but they do improve well-being (volunteering, caring family roles) - measures 'having', not well being - does not take into account income distribution - does not take into account the amount of leisure we might forego to engage in work |
| <p>Alternatives to GDP</p> | <ul style="list-style-type: none"> - Human Development Index - Gender Empowerment Measure - Human Poverty Index - Index of Social Health <p>All measure progress in one single number - problematic</p> |

Defining and analysing capitalism + Economic prosperity, crisis & problems

Key relationships:

(a) Institutions: market, state, community



(b) Spatial scales: global, national, local



(c) Systems: economic, social, ecological



Figure 2.1 Three trilogies: institutions, spatial scales, and systems.



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| Managing common resources | <p>Elinor Ostrom</p> <ul style="list-style-type: none">• Usual inference is that collectively owned resources will be overused because, without a price mechanism to charge for personal use, there is a tendency for everyone to take more than their fair share |
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| | <ul style="list-style-type: none"> • Example: lands in medieval societies became degraded because they were overused (acc to Garrett Hardin), more sustainable to convert into smaller private plots • Misreading of history, quality of common land actually maintained over centuries, privatisation created need for overuse • When faced with economic circumstances where interdependence of the actors is crucial to the outcome, sophisticated ways of addressing and managing the interdependence emerge |
| Elements of capitalism | <p>Labour market</p> <p>Capital market</p> <ul style="list-style-type: none"> • Banks • Stock exchange <p>Land market</p> <ul style="list-style-type: none"> • Land could be owned collectively by the state and leased to households and businesses • Form of land ownership not a fundamental feature <p>Markets for goods and services</p> <p>Distinctive role of the state</p> <ul style="list-style-type: none"> • Regulates and defines property rights on which economy based • Umpire • Redistributes market incomes to ensure social stability • Provides goods and services not provided by market (fire fighting, law enforcement, defence) <p>Expansionary tendency</p> <ul style="list-style-type: none"> • Growth-oriented |

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| Classical political economy | <ul style="list-style-type: none"> • Adam Smith, The Wealth of Nations • Analysed capacity of economic system based on market exchange • Believed capitalism opened up opportunities for individuals, increased productivity, aided growth of trade • Some had reservations about impact on living standards |
| Neoclassical political economy | <ul style="list-style-type: none"> • Free markets produce efficient outcomes • Attempted to put economics on a more scientific basis |
| Marxist economics | <ul style="list-style-type: none"> • Free market system produces inequality • Fundamental transformation of political system needed |
| Reformist perspectives | <p>Thorstein Veblen</p> <ul style="list-style-type: none"> • Critical of capitalism, emphasised social manifestation of business and consumer behaviour • Amelioration of problems of capitalism, e.g. welfare system <p>John Maynard Keynes</p> <ul style="list-style-type: none"> • Wrote between 1st and 2nd World War • Capitalist system 'morally objectionable', better than alternatives |

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| | <ul style="list-style-type: none"> • Save the essentials of a capitalist system within the framework of a strong and systematically interventionist state (Eric Hobsbawm) • Ideas became basis of a new orthodoxy for 30 years after end of WW2: 'neoclassical synthesis' blend of Keynesian macroeconomics and neoclassical microeconomics • Collapse of growth boom end of 1970s led to assault on Keynesian economics |
| Monetarism | <ul style="list-style-type: none"> • Capitalism could work better when the state interfered least • Want to get rid of constraints imposed by trade unions and govt intervention |

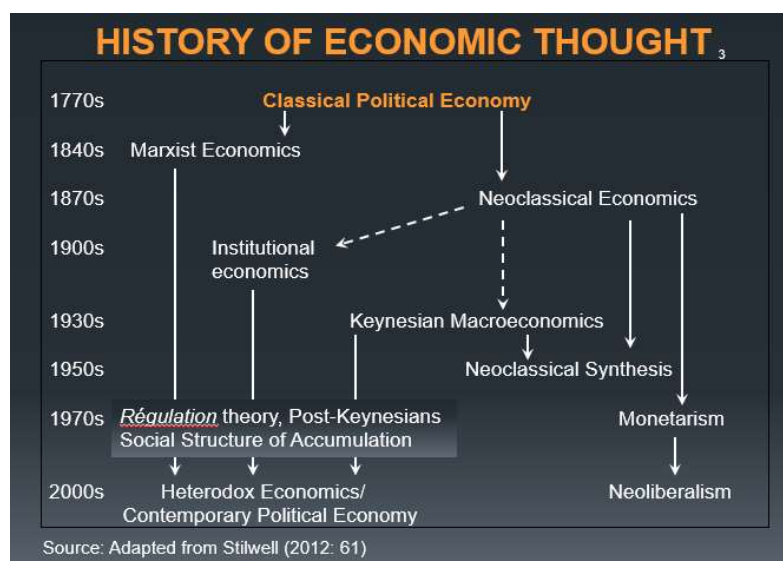
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| Economic change | <ul style="list-style-type: none"> - capitalism rise fall cycle - occurs when capital is restructured |
| The reorganisation of business | <ul style="list-style-type: none"> • mergers and acquisitions, hostile takeovers • Reduce costs, eliminate inefficiencies, increase market share, leads to higher profits • Social costs include job losses, customer interests sometimes not considered <p>Issues:</p> <ul style="list-style-type: none"> - should these processes be regulated? - is competition preferable to monopoly - should policies foster the growth of 'national champions'? |
| The geographical restructuring of production | <ul style="list-style-type: none"> • Globalisation • For business/transnational corporations (TNCs) <ul style="list-style-type: none"> • Seek to minimise labour costs and tax, find new markets, less restrictive environmental regulations • Proliferation of fragmented productive activities and business networks across the world with increasing interdependencies • Examples? Nike Toyota, costs of labour in Tasmania 20 times higher than what have to pay in India or Thailand • The changes support busin |
| The application of new technologies | <ul style="list-style-type: none"> • Implications for employment? <ul style="list-style-type: none"> • Structural unemployment – problem of transition • BUT ... new technologies are affecting sectors which took up past displaced labour (eg agricultural labour moved to cities to work in manufacturing, now manufacturing jobs being lost to mechanisation) • Waves of technological change • Good for business but social issues |
| The reorganisation of | <ul style="list-style-type: none"> • Changes in the capital-labour relationship • This is in part driven by: <ul style="list-style-type: none"> • Production and technology changes |

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| employment conditions | <ul style="list-style-type: none"> • The reassertion of managerial prerogatives • The drive for greater flexibility • Casualisation of work/contract labour • Greater economic insecurity • Increased intensity of labour • Fordism to post-Fordism • Less interests but may lead to economic and social problems <ul style="list-style-type: none"> • 'Race to the bottom' • Job creation/unemployment; higher incomes/lost incomes; skill development/skill loss • Capacity of governments to fund local infrastructure (less tax revenue) • Environmental damage • This often involves the loss of jobs |
| Changes in the economic role of governments | <ul style="list-style-type: none"> • Governments set 'the rules of the game' • Since the ascendancy of neoliberalism <ul style="list-style-type: none"> • Freer market forces claimed to lead to more efficient outcomes • Deregulation, privatisation, trade and capital liberalisation, cut in company tax rates • Outcomes compared to the rhetoric of policy <ul style="list-style-type: none"> • Reorientation of economic activities of government through regulation and protection of markets in which corporations operate • Winners and losers , government focuses less on people |
| Changes in prevailing economic ideologies | <ul style="list-style-type: none"> • Any economic system is sustained by ideologies that embody beliefs about how the economy operates and the social values that it serves • Contemporary capitalism has neoliberalism <ul style="list-style-type: none"> • The ascendancy of 'free-market economics' • Contrary belief about more extensive government role to pursue social goals • Challenged with onset of global financial crisis but still a significant force • Focus on individuals, not households or families, maximise individual efficiency |
| Dollars per person measure of development | <ul style="list-style-type: none"> - doesn't say how equitable - no reflection of accumulation of wealth, only income - all money treated the same even though makes different contributions to human welfare |
| Trade imbalances | <ul style="list-style-type: none"> - if value of imports > exports, it's a trade deficit, not making enough money to spend, less tax revenue, need to borrow, interest accrues |

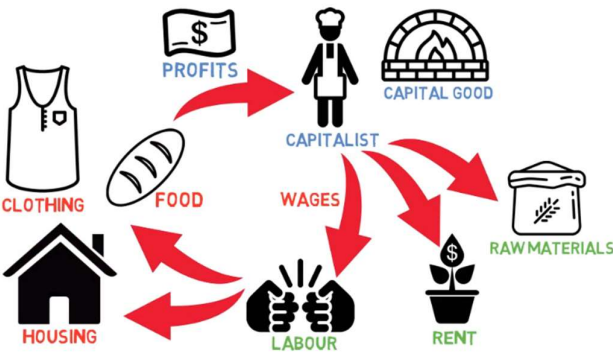
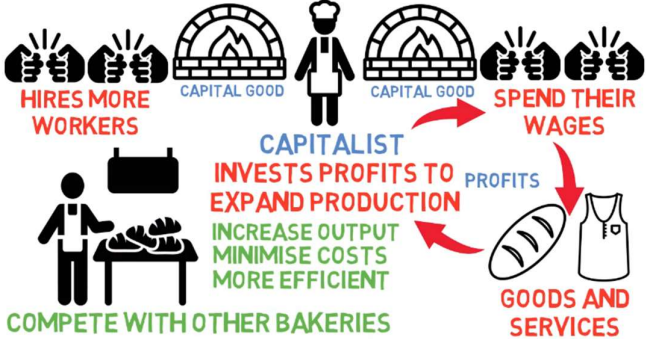
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| Speculation and financial instability | - prevalence of speculation, bundling of mortgages and then reselling, creates toxic debt, race for profit created dangerous conditions leading to unemployment |
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Classical political economy

This lecture introduces the first school of economic thought which will be examined in this Unit of Study - Classical Political Economy. We will discuss the **concepts developed by Adam Smith to understand the nature of capitalism** emerging at that time as well as how he saw the organisation of society and the drivers of economic growth. We will also consider the contributions of other classical political economists such as **David Ricardo and Thomas Malthus** and the contemporary influence of their ideas. The lecture will then focus on the philosophical and political beliefs underpinning **Classical Political Economy** and the form of economic analysis that these economists created.



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| Emergence and philosophy | <ul style="list-style-type: none"> • Classical political economy emerged as capitalism developed, economy undergoing rapid transformations, sought to explain it • Transition from feudalism to capitalism created conflict • Adam Smith regarded as the founder (TWOOF), thought that individuals are basic units of society, everyone acts according to their own self-interest, competition drives economic progress, better technologies and methods lead to more profit, society profits because better production and more resources • Adam Smith thought that basic role of government was to preserve justice, government must carry out important societal functions • Opponent of monopoly • Challenged mercantilism, in which state granted major privileges to large trading companies • Challenged religion which preached that increased wealth should go along with charity to the poor • Free market, free from state and religious interference, would generate the most economic and social progress |
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| <p>Conception of society</p> | <ul style="list-style-type: none"> • Factors of production include: land, labour, capital • Economic agents are rational individuals • Society is organised into 3 economic classes • Landowners own land, earn rents • Workers provide labour, earn wages • Capitalists own means of production, earn profit <p>Basic assumptions</p> <ul style="list-style-type: none"> • Individualism: individual basic unit of society • Hedonism: individuals driven by self-interest • Rationality • Inertia: most people basically lazy, only stimulated by promise of personal gain |
| <p>Circular flow of income</p> | <p>Classes part of circular flow of income, which creates economic surplus (production exceeds what is needed to keep economy at same level)</p> <p style="text-align: center;">WHAT IS NECESSARY FOR THE PRODUCTION OF BREAD?</p>  |
| <p>Economic surplus</p> | <p>creates economic surplus (production exceeds what is needed to keep economy at same level)</p>  <ul style="list-style-type: none"> • Social and economic benefits arise from pursuit of self-interest |
| <p>Assumptions about</p> | <ul style="list-style-type: none"> • Political philosophy of liberalism |

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| <p>motivations and behaviour</p> | <ul style="list-style-type: none"> • Social beliefs - individual is the basic unit of society, individuals are hedonistic, self-interested decisions made rationally, individuals lazy unless stimulated by personal gain • Economic beliefs - individuals should be free to act in their self-interest, self-interested behaviour brings benefits to society through competition, division of labour increases output, efforts to help the poor are a positive evil (lowers incentive to find a job, bad for economy) • Political beliefs - the state has three roles: defence, justice, infrastructure, the market is best left alone by the state (laissez-faire), state involvement in the market is an unnecessary evil (unless non-involvement leads to more evil) |
| <p>Markets are best economic organizer</p> |  <p>MARKETS ARE PROMOTED AS THE BEST FORM OF ECONOMIC ARRANGEMENTS</p> <p>INDIVIDUAL PREFERENCES ARE SIGNALLED TO PRODUCERS</p> <p>SELLERS COMPETE WITH ONE ANOTHER TO MEET THE DEMAND</p> <p>COMPETITION KEEPS PRICES LOW AND ENSURES RESOURCES ARE USED IN THE MOST EFFICIENT WAY</p> |
| <p>David Ricardo</p> | <ul style="list-style-type: none"> • strong advocate for breaking down barriers of international trade • If each nation specialised in the production of goods and services for which it was best suited and then traded its surplus with other nations everyone wins (Comparative advantage) |
| <p>Thomas Malthus</p> | <ul style="list-style-type: none"> • Argued that there would be a persistent tendency for population growth to outstrip rate of growth in food production, leading to famines, illness and wars • Attempts to raise wages self-defeating • Charity encourages faster population growth and discourages productive effort • Amartya Sen argues that his 'food availability doctrine' pays insufficient attention to the importance of political factors in explaining and resolving poverty • Ultimate unsustainability of growth |
| <p>Jean-Baptiste Say</p> | <ul style="list-style-type: none"> • 'Say's Law', supply creates its own demand • Production of goods and services will generate the national income needed to purchase those commodities • Under consumption is never a problem • Malthus disagreed, argues that wages (because they are not the total cost of production) may not be sufficient to purchase all which is produced,, if prices fall then incentive to invest falls, excessive savings have similar effect) |