

# UNDERSTANDING THE POLITICAL WORLD

## POLITICAL ECONOMICS

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November 18, 2015

# Outline

- Ideal-Type Political Economies
- The Mixed Economy
- Actual Political Economies
- Political Economy and Politics

# Two Ideal-Type Political Economies

- An ideal-type economy is what a certain economy might be like in its pure form.
- An ideal-type economy is illustrative but it does not necessarily correspond to any real-world example.
- The two ideal-type political economies are:
  - The **market economy** (also called **price system**)
  - The **command economy** (also called **command system**).

# Fundamental Questions

To distinguish between the market economy and the command economy, five fundamental questions will be examined:

1. Who controls the *factors of production*?
2. Who determines what *goods are produced*?
3. Who establishes the *price of the different resources and goods*?
4. Who decides how *resources and goods are distributed*?
5. What is the role of the *state*?

# The Market Economy (Private Control)

- Factors of Production
  - Labor: The worker decides who he/she will offer his/her work and the compensation he/she will receive
  - Land and Capital: The owner decides the conditions the resource will be employed
- Goods Produced
  - Profit maximizing behavior of the firm determines what resources to acquire and what goods to produce
  - Adam Smith's (1723-1790) "invisible hand"
    - Production is guided by the "invisible hand"
  - In terms of demand and supply, this system is demand-oriented
    - The firm attempts to assess the demand for various goods in the market and then transforms the factors of production into goods that will maximize profits

# The Market Economy (Cont.)

- Price of Resources and Goods
  - The market forces of demand and supply guided by the “invisible hand”
  - Nothing has value except to the extent that someone will exchange resources for it
  - In most circumstances, many producers offer similar resources and goods that result in vigorous competition
  - A basic economic assumption in a market economy is the continuous adjustment towards an equilibrium point
    - Quantity demanded = Quantity supplied
- Distribution of resources and goods
  - The invisible hand of the market
  - Market participants pursue their own self-interest

# The Market Economy (Cont.)

- Government Role
  - Government intervention is minimal
  - Prevent market participants from doing violence to each other
  - Protect its citizens from the external environment
  - Preventing violation of its sovereignty or its citizens' rights by the external environment
  - In meeting these responsibilities the government may participate in the market, decrease or increase taxes, implement trade incentives or restrictions, etc.

# The Command Economy (Government Control)

- Factors of Production
  - In a pure command economy, the government controls/determines how the factors of production will be utilized
  - The government owns the land, the natural resources, the factories, the machines, and so on.
  - The government also controls labor
    - It decides the conditions and purposes for which individual will offer his/her labor
- Goods Produced
  - The government is in a sense the one firm that produces all major goods in the system
  - The government prepares an *economic plan* that specifies what, how, and how much will be produced
  - In terms of demand and supply, this system is supply-oriented
    - The government attempts to make the best use of the resources and transform them into as many appropriate goods available for the consumers

# The Command Economy (Cont.)

- Price of Resources and Goods
  - Since the government controls all factors of production (Monopsony) and is the firm producing all goods (Monopoly), it is able to set the prices
  - The government tells farmers how much to produce and also sets the price
  - The government will determine who will produce and the wages and benefits they will receive
- Distribution of Resources and Goods
  - The government's economic plan determines who will receive which goods and how much
  - For example, farmer X will receive 30,000 corn seeds per acre
  - For example, 1 pound of rice per family per week in city X
  - Command economies aim to distributing necessary goods (especially food, shelter, education, health care) to every person on an equal basis
  - However, the crucial decisions about the distribution of goods are made by those with power in the political system

# The Command Economy (Cont.)

- Government Role
  - Dominant and overwhelming role
  - Controls, plans, set prices, and distribute all resources and goods
  - Any surplus belongs to the state and will be used to serve the objectives of the state

# Benefits and Problems of Market and Command Economies

## Benefits

## Problems

### Market Economy

- |   |  |   |
|---|--|---|
| <ul style="list-style-type: none"><li>• Decentralized (no central plan)</li><li>• Demand Oriented</li><li>• Competition</li></ul> | <ul style="list-style-type: none"><li>• Market-driven decisions</li><li>• Goods' quality and prices reflect consumers' desires</li><li>• Energetic and efficient</li></ul> | <ul style="list-style-type: none"><li>• Economic cycles (boom and bust, inflation and deflation, and growth and recession)</li><li>• Goods are reflective of consumers' desires may make inappropriate use of societal resources</li><li>• Inequalities in wealth and resources</li></ul> |
|---|--|---|

### Command Economy

- |   |   |  |
|---|---|--|
| <ul style="list-style-type: none"><li>• Centralized (central plan)</li><li>• Supply Oriented</li><li>• No Competition</li></ul> | <ul style="list-style-type: none"><li>• State plans use of societal resources</li><li>• Production and distribution of social and individual needs</li><li>• Work for common good; relative equality of wealth and income</li></ul> | <ul style="list-style-type: none"><li>• Overcentralized control; limited innovation; lack of change</li><li>• Surpluses and shortages; lack of coordination</li><li>• Little initiative; shoddy products; low productivity</li></ul> |
|---|---|--|

# Critics

## Market Economies

### Resource Inequality

- Rich gets richer
- Those with few resources tend to lose market power
- Some people may lack resources to meet the standards of living
- Inequalities of wealth, power, and status
- Conflict between rich and poor

### Production for Profit

- Proliferation of goods that are profitable and scarcity of goods that are not profitable
- Wasteful competition among firms if consumers are uneducated

### Economic Cycles

- Economy experiences cycles (scarcity and inflation, surpluses and deflation, boom and growth, recession or depression)

## Command Economies

### Limited Incentives for Efficiency

- No initiative to produce high quality goods
- Poor quality goods
- Access to existing goods
- No incentive for hard work
- Workers becomes conservative and lazy

### Unresponsive Production

- Production of good that are not directly reflective of consumer demand
- Central planners decide what people will have
- Severe shortages of some goods

### Overcentralization and Inflexibility

- Central planners usually do not receive and react effectively to information regarding miscalculations and mistakes in the development or implementation of the state plan

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# The Mixed Economy

- The **mixed economy** can be understood as an attempt to combine the strengths of the market and command economies, while minimizing the shortcomings of each.
- The government owns or directly controls some of the major factors of production, such as those relating to key commodities (e.g., coal, oil, steel), and to key infrastructure systems (e.g., transportation, telecommunications), and to key financial resources (e.g., the banks).
- Most public firms are under direct control of the government but usually interact and even compete with private firms.
- Price of resources and goods is established in a manner that is more akin to the market system but there is government intervention to insure national priorities
  - Set the price of certain factor of production, including wages; set guidelines for market prices of goods; regulate competition among firms; etc.
- The great challenges for the mixed economy concern the difficulties of striking a proper balance between competition and control, between free market and a planned economy, between private profit and a sharing of society's resources.

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# Actual Political Economies

- The contemporary world does not correspond to any ideal-type political economy.
- In a sense, all political economies are mixed.
- Countries can be classified on a continuum from one ideal type (pure market economy) to the other ideal type (pure command economy).
- In politics, a different set of labels is often attached to political economies.
- Much of the discussion describes political economies in terms of three “isms”: capitalism, socialism, and communism.
- A system near the command end of the continuum is associated with communism while a system with increasing dominance of the private market is associated with capitalism.

# Actual Political Economies (Cont.)

- How do we determine when an actual state changes from one “ism” to another?
  - There are no precise operational measures that serve that purpose.
- What is the domain of socialism?
  - Socialism is sometimes equated with communism, and some states use the terms communism and socialism almost interchangeably
  - For example, the former Soviet Union was actually called the Union of Soviet *Socialist* Republics
  - For example, some Western European countries (such as Sweden) are often labeled as democratic socialist states, but there were substantial differences between the Soviet Union and Sweden

# Communism versus Socialism

## Communism

- The state (on behalf of “the people”) attempts to control virtually all important factors of production in the society.
- Fundamental commitment to total economic and social equality among all citizens.

## Socialism

- Private ownership and control of significant factors of production is possible.
- Policies attempt to reduce inequalities significantly, but they do not aim for total economic equality.

Refer to sheet “Communism versus Socialism in Marxist Theory”

# An Example of Communism: The former Soviet Union

- The Soviet Union or the Union of Soviet Socialist Republics (USSR) or Союз Советских Социалистических Республик (СССР) lasted from 1922 (had its roots in 1917) to 1991
- The political system owned and controlled the major means of production in the society and there was a detailed central economic plan.
- More than 95% of the Gross National Product (GNP) was in the public sector.
- Towards 1990 the Soviet Union allowed a limited free market in the provision of consumer goods but remained committed to the state's control and allocation of societal resources.
- On 25 December 1991, the Russian Federation (formerly the Russian SFSR) assumed the Soviet Union's rights and obligations and was recognized as its continued legal personality.

# An Example of Socialism: Sweden

- Sweden is classified as a socialist system (mixed political economy)
- While the state directly controls some of the major means of production, many others are under private control and are constrained by the state only indirectly, through its policies of regulation, planning, and taxation.

# Socialism versus Capitalism

## Socialism

- Active state intervention.
- A significant share of major productive resources are either owned by the state or managed by the state-controlled organizations.
- Use public policy to redistribute societal resources towards those citizens who are less advantaged economically.

## Capitalism

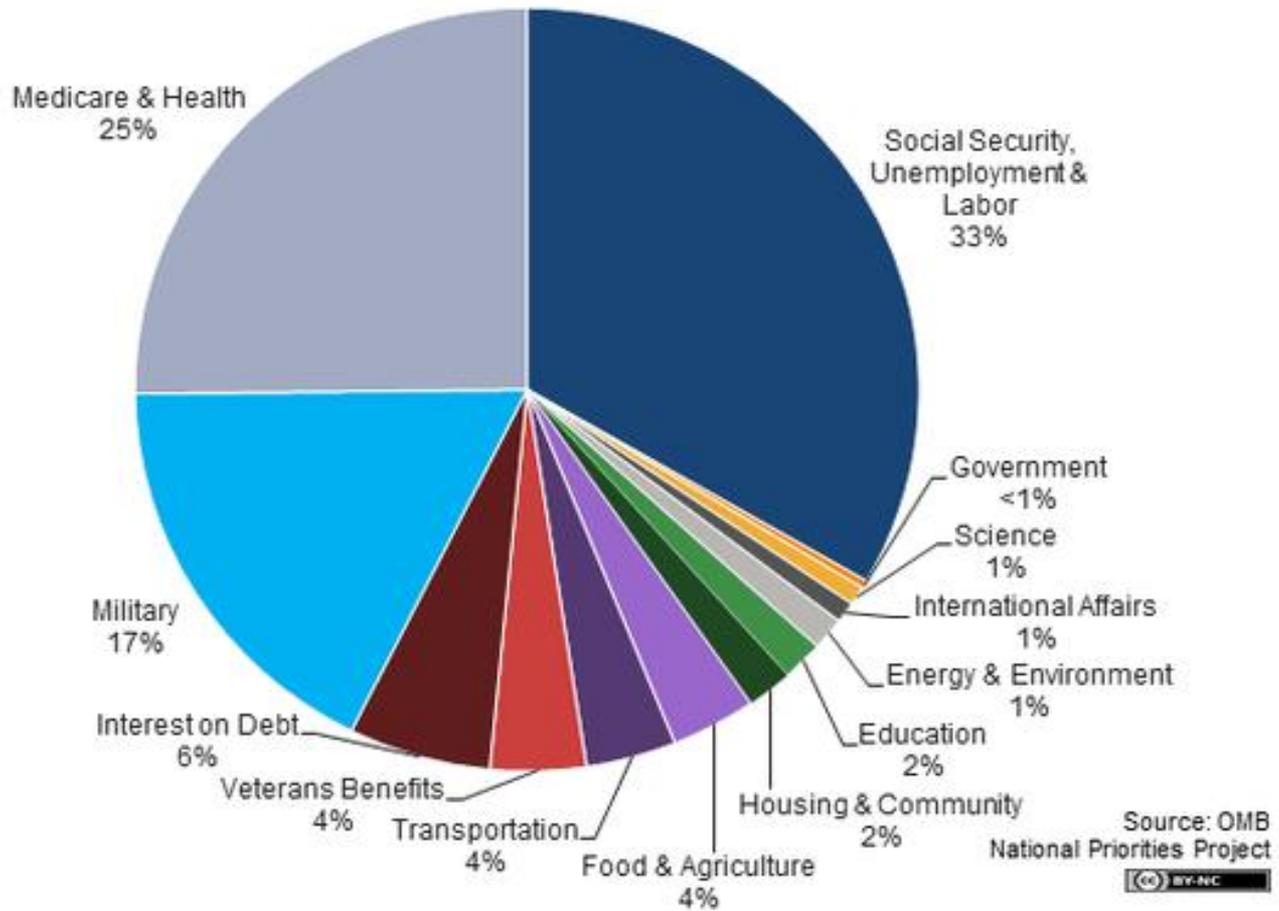
- Minimal state intervention.
- A significant share of major productive resources are privately owned.
- Policy actions of the capitalist state shape the general form of production and distribution. There are policies to protect individuals and groups from severe economic deprivation.

As a system becomes more capitalist, a larger share of the activities and decisions are made by private parties operating in market economies.

# An Example of Capitalism: The United States

- About 65% of the GDP is in the private sector.
- About 35% of the GDP is in the public sector.
- It could be argued that the US is a mixed political economy.
- It is classified as a market economy because of the substantial power and discretion exercised by private actors.
- GDP = \$17.42 trillion (2014 estimate)
- Federal Spending = \$3.5 trillion (2014)
- Department of Defense's (DoD's) Base Budget = \$502 billion in 2014
- Department of Education Budget = \$53.8 billion (2014 President Budget)
- Temporary Assistance for Needy Families (TANF) Annual Budget = 17.35 billion (FY2014)

## President's Proposed Total Spending (Fiscal Year 2014)



# Corporatism

- Many scholars refer to the political economy of some states by *corporatism*.
- Corporatism is characterized by a blend of public and private control under an activist state.
- Corporatism is “a system where government grants official recognition to a limited number of interest associations that are given a virtual monopoly in representing a certain sector of the economy before the public authorities. The price paid for such a privileged position is the general expectation that the leaders of the peak associations or other organizations involved will comply with the policy initiatives of government officials” (Hagopian 1984).
- Corporatism blends feature of capitalisms (e.g., private ownership, private profit) and socialism (e.g., extensive state economic planning, coordination of major factors of production with the state’s conception of the national interest).

# Fascism

- Fascism is not really a political economy.
- Rather, fascism is best described as an ideology and a type of mass political movement.
- As an ideology, fascism is essentially defined by its opposition to forces that might weaken the unity and harmony of all elements of the state.
- Most importantly, fascism is:
  1. Anticommunist: It is a reaction against the egalitarian ethic, against the occurrence of a class struggle, and against the seizure of private property.
  2. Antidemocratic: It views democratic, multiparty politics as particularistic and unstable.

# Fascism (Cont.)

- There have been only two major fascist regimes in the twentieth century:
  - Nazi Germany under Adolf Hitler (1933-1945)
  - Italy under Benito Mussolini (1922-1943)
- Other nonconstitutional regimes classified as fascist include:
  - Spain under Francisco Franco (1934-1975)
  - Chile under Augusto Pinochet (1973-1990)
  - Zaire (formerly Republic of Congo) under Mobuto Sese Seko (1965-1997)

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# Political Economy and Politics

- Are political economies linked with particular styles of politics?
- Is it impossible to have command economies and democratic politics? Democratic Communism?
- How far toward a total command economy might a system move while maintaining democratic politics?
- Is there a logical or structural inconsistency between state control of the economy and popular control of the state?
- Could a capitalist system be highly democratic?

# References

- Danziger, James N. *Understanding the Political World: An Introduction to Political Science*. Longman Publishing Group: New York, 1991, pp. 156-171.