

Sociology 4321: Globalization
Fall 2005
Class 4: States and Markets 1

Copyright © 2005 by Evan Schofer
Do not copy or distribute without
permission

Announcements

- 1. Trouble finding readings?
 - A few articles aren't on e-reserve...
 - Instead, go to online syllabus, click on links provided:
 - <http://www.soc.umn.edu/~schofer>
- 2. Thanks to those who informed me about missing pages in e-reserve articles
 - All on-line readings have been corrected.

Class Objectives

- 1. Briefly discuss "Commanding Heights" video
 - Esp. British coal miner strikes, privatization, etc.
 - How much should the government protect workers?
- 2. Current events:
 - NWA bankruptcy (Handout)
- 3. Briefly discuss one of the readings
- 4. Lecture: States and Markets
 - Basic economic concepts and definitions
 - Fundamentals of how states affect markets
 - Foundations for understanding economic globalization.

Commanding Heights

- After WWII, Britain created a “mixed” economy
 - The government owned or subsidized many industries
 - Avoided “boom/bust” cycles of capitalism
 - Treated workers better than “profit-focused” companies
 - Workers were paid a “living wage,” good benefits
- But: That is all very expensive... mines weren’t as competitive as “private industry”
 - They cost 3 Billion per year more than they earned selling coal
 - Cost of government spending on coal mines (&other industries) plus other economic problems were hurting the economy.

Commanding Heights

- Thatcher plan: close inefficient industries; cut government spending, privatize in order to:
 - 1. Increase market incentive for new companies to invest, grow
 - 2. Reduce huge government deficits (which can be economically harmful)
- Problem: What do you do about 180,000 coal miners and their families?
 - Miners argued that 3 billion a year in government subsidies is worth it... supports families and communities
 - Note: strikes (which cut off coal production & coal-based electricity) were done to pressure the government to keep the mines open.

Commanding Heights

- Who “feels the pain” of economic restructuring?
 - And how much should be done about it?
- Examples:
 - Workers in bankrupt airlines
 - Should the government give money to “bail out” airlines (as they did in 2001/2)?
 - Communities in the Minnesota Iron Range
 - Small family farmers
 - Others?

Handout: Northwest Airlines

- What does “Chapter 11” mean?
 - Is it really that bad? After all, the planes keep flying...
- In short: NWA can’t pay the bills... is losing money for the foreseeable future
 - And NWA owes a lot of money to “creditors” (banks, etc)
- Option #1: “Liquidate” – Close the company, fire all the workers, sell all the planes
 - The “proceeds” of the sale go to the creditors
 - Like when a car is “repossessed”
 - Downsides: Destroys the company; but usually doesn’t raise enough money to pay off debts; workers feel “pain”.

Handout: Northwest Airlines

- Option #2: “Restructure”
 - Filing “Chapter 11” protects a company from creditors
 - Under court supervision, the company negotiates with creditors
 - OK... I can’t pay you 500 million in September... how about if I pay you 300 million in October?
 - There is the potential for “win/win”
 - Creditors get paid back more \$\$ compared to liquidation
 - Company keeps operating
 - BUT: in a restructuring plan, the company has to radically cut costs & increase profits to please creditors
 - Union contracts are re-negotiated, workers are fired
 - Again... workers “feel pain”.

Handout: Northwest Airlines

- Let’s take 3-5 minutes to read a short article on the NWA bankruptcy
 - Issues to reflect on:
 - Why did deregulation/competition led to bankruptcies?
 - Was deregulation worth it?
 - It produced 30 years of cheap flights; improved competition; better “service”; stockholders & executives made millions
 - But, now we have a “bust”... workers feel pain; government is “bailing out” pension plans; etc.

Readings: Golden Straightjacket

- Quote of the day:
- “Ideologically speaking, there is no more mint chocolate-chip, there is no more strawberry swirl, and there is no more lemon-lime. There is only **free-market vanilla** and **North Korea.**”

– Friedman, p. 86

Readings: Golden Straightjacket

- Question: What is the “Golden Straightjacket”?
 - It is a free-market capitalist economy
- Question: Why is it “golden”?
 - It often creates large amounts of wealth
- Question: Why is it a straightjacket?
 - Because it limits politics... countries are trapped into doing what is best for “business”
 - “Deviate too far... and investors will stampede away”
 - Friedman, p. 87-88

Readings: Golden Straightjacket

- Question: What is the “Electronic Herd”
 - It is global investors that will only invest in countries that “wear the golden straightjacket”
- Claim: Governments are no longer free to do as they please
 - Economic globalization forces nations to “put on the straightjacket” – or face the consequences.
- Remark: Friedman writes very confidently
 - But, there is substantial debate among scholars as to the implications of the “electronic herd”...

Econ 101: Definitions

- **Gross Domestic Product (GDP)**
 - “gross” means “total”
 - Definition: The total economic value of things produced within a given country
 - Note: GDP is often measured “per capita,” which gives a sense of wealth per person
- Examples: GDP in 2004 (CIA World Factbook)
 - United States: \$11,750,000,000,000 – trillions!
 - \$40,100 per capita
 - Brazil: \$1,492,000,000,000; 1.5 trillion, \$8,100 per cap
 - Liberia: \$2,900,000,000 – 3 billion, \$900 per capita.

Econ 101: Definitions

- **Economic Growth:** An increase in GDP
 - Growth means: more production, more profits, more wealth, more jobs, more income, more consumption, more everything!
 - Growth is generally considered good by all
 - Except environmentalists who foresee ecological limits
- **Recession:** A period of decline in GDP
 - Fewer jobs, less consumption, etc...
- **Depression:** A period of severe and protracted decline in GDP
 - Massive unemployment, poverty, hunger; political unrest.

Econ 101: Growth

- Why do economies grow?
- Long term growth comes from:
 - New technologies
 - Example: Machines allow people to produce more goods
 - Increased skills and efficiency of labor force
 - Example: Highly educated workers can get more done
 - Investment
 - Example: Money spent to build more factories
- Short term growth can be sped up by:
 - Greater consumption by people, firms, governments
 - Spending \$\$ creates demand, speeds up economy.

Econ 101: Business Cycles

- Issue: Economic growth isn't always smooth
- Capitalist economies are prone to cycles of "boom" and "bust" – the "**business cycle**"
 - In good times, everyone gets optimistic, builds a lot of factories... economy and jobs boom
 - Unemployment is very low, wages and prices go up
 - Eventually, economic capacity becomes too great
 - More is produced than people are willing to buy
 - Firms have layoffs or go bankrupt, unemployment goes up, prices go down
 - Governments use policies to avoid extreme cycles

Econ 101: Business Cycles

- Question: Do you know anyone who lost their job in the a recession?
- Question: Do you believe the government should directly intervene to prevent unemployment?
 - Either hire people itself to do public works projects; Or pass laws making it harder to fire people?
- Issue: In a depression, if unemployment goes too high then consumption drops
 - Without consumer spending, economy can go into a deflationary spiral...
- Government offers unemployment insurance, in part, to prevent this

GDP = Prosperity?

- Question: What is the relationship between GDP growth and **prosperity**?
- Answer: It depends on who you ask
 - Political conservatives and proponents of free market argue that **growth** is the best route to prosperity
 - Claim: In the long run, the poor are better off in a fast growing economy, even if the rich get most of the reward
 - Imagery: Rather than divide the "pie" evenly, the pie needs to grow so everyone's piece gets bigger...
 - Political liberals and socialists have generally stressed the value of social equality
 - Equity is more important than maximizing growth .

States and Markets

- Issue: How is the state related to markets?
- Marx was right about some things:
 - We all depend on the economy for our well being!
 - States cannot exist and function without resources from the economy
- Historically, states have tried to generate economic growth
 - Either for the collective good, or in order to wage war.

States and Markets

- Question: Can markets exist without states?
 - What do you think? What does capitalism require?
- Answer: No! (at least not on a large scale)
- Capitalism requires:
 - Private property – protected by laws, police, courts
 - Legal systems – to enforce private property, contracts
 - Infrastructure – roads, ports, etc...
 - National defense
 - Regulation of markets
 - People disagree about how much... but most favor some degree of regulation to prevent huge disasters, fraud, etc...

States and Markets

- Question: Why do states try to affect markets?
- 1. To change economic behavior
 - Encourage growth, change distribution of wealth
 - To “smooth out” the business cycle
- 2. To affect society more broadly
 - Reduce environmental degradation, reduce discrimination, improve medical care, etc...
 - In short: To achieve things that markets don’t always do by themselves: “Collective goods”.

States and Markets

- Question: How can states affect markets?
 - 1. Fiscal policy – taxes and spending
 - Definition: Fiscal = “of or relating to taxation, public revenues, or public debt” (Webster)
 - 2. Monetary (money) policy – printing & lending money
 - 3. Laws and Regulations
 - 4. Direct ownership of production
- I’ll discuss examples of each...

Fiscal Policy: Taxes

- What does the government tax?
 - Individual income
 - Corporate income
 - Transactions (sales tax, taxes on trade)
 - Property owners
 - Activities that require fees (e.g., driving, fishing, etc)
- Taxes generate **revenue** for the state
- By taxing some things more than others, states can affect social and economic behavior.

Fiscal Policy: Taxes

- 1. Government can control economy by setting the overall tax rate
 - Highest federal income tax rate in US is around 35%
 - Actual taxes paid are lower due to credits, loopholes, etc.
 - Low taxes can create short term growth
 - By increasing spending, consumption
 - Low taxes also can increase investment, increasing long term growth
 - The “electronic herd” is drawn to low taxes
 - Higher tax rates support more government services
 - And allow greater redistribution of wealth in society.

Fiscal Policy: Taxes

- 2. Government can use taxes as incentives
 - High taxes on cigarettes may reduce consumption
 - Tax breaks for “clean energy” may increase usage
 - High taxes on imported goods reduce trade
- 3. Government can tax to redistribute wealth
 - Government can target groups:
 - Wealthy vs. poor, old vs. young, people vs. companies
 - “Progressive” tax system = shifts \$ toward poor
 - “Regressive” tax system = shifts \$ toward rich
 - Ex: Sales taxes tend to be regressive.

Examples: Bush Tax Cuts

- 2001: Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)
 - Reduced income tax rates (percentage people must pay)
 - Dividend tax rate reduction
 - Dividends = profits given to investors
 - Goals: Encourage people to spend, invest: speed up the economy...
 - Reaction from economists: Mixed.
 - Cuts mostly benefits the rich, who may not spend the extra \$\$ (which stimulates the economy)
 - Very costly (government already has budget deficit).

Examples: Bush Tax Cuts

- Tax Plan from White House web site [excerpt]:
- Replacing the current tax rates of 15, 28, 31, 36, and 39.6 percent with a simplified rate structure of 10, 15, 25, and 33 percent
- Doubling the child tax credit to \$1,000 per child and applying the credit to the Alternative Minimum Tax (AMT)
- Reducing the marriage penalty by reinstating the 10 percent deduction for two-earner couples
- Eliminating the death tax.

Examples: Bush Tax Cuts

- Current tax issue: the “Estate Tax”
 - Estate = property and money of a person who died
 - Called “death tax” by opponents...
- If someone dies in 2005, all assets *above 1.5 million* are taxed
 - About 1% of estates pay **some** estate tax...
 - Only about 500 estates (worth over 20 million) pay a lot
 - Average tax on such estates = 17%
 - Raised 5.2 Billion in taxes in 2003

Examples: Bush Tax Cuts

- Republicans want to abolish the estate tax
 - They oppose the government taking money & property
 - People have earned it (and payed taxes on those earnings)... why can't they keep it? Why are they “double-taxed”?
 - They want to keep government small
 - “Starve the Beast” strategy
 - Some want to stimulate the economy
 - And, many republicans are wealthy... will benefit...
 - NOTE: They also argue that it saves family farms... which might have to be sold to pay the tax
 - Evidence has clearly refuted this.

Examples: Bush Tax Cuts

- Democrats want to keep the estate tax
 - They say: It takes from the wealthiest, who can afford it most
 - It prevents the creation of an idle class of “super-rich”
 - It generates a lot of revenue... and the government is currently in a budget deficit.

Fiscal Policy: Spending

- Government can also affect economy by adjusting how it **spends** money
- **Budget deficits** occur when the government spends **more** than it earns in taxes in a year
 - The government can do this by borrowing money...
 - Result: the national debt increases
- **Budget surpluses** occur when the government spends **less** than it earns
- Current national debt: 6,822,000,000,000
 - Large government debt can harm the economy

Fiscal Policy: Spending

- Government spending can “jump-start” the economy
 - State may spend directly, or give money to people
 - Keynes: “Government should spend against the wind”
 - Example: “New Deal” spending, war spending helped create jobs and economic growth
- But, consistent high government spending can harm economic growth
 - High deficits, debt can lead to inflation
 - Example: “stagflation” in 1970s.
