

# Political Economics

## Lec.2

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## What are the Different Research Areas of Political Economy?

### Collective Decision-Making: Social Choice and Political Economy

- **Social choice** would be simple if each groups of people involves more or less **identical** members.
  - ➔ ■ Any member or subset of members chosen at random would be able to **articulate** the **interests** of the whole.

**But groups are, in fact, not at all like that.**

The **interests** of the individual members differ and no one member has exactly the same interest as **the group itself**.

- Even for the **family**, we speak of its interests as separate from the **interests** of parents and siblings.

- And when we speak of more **specialized groups** with limited purposes, we need to **specify** ever more precisely just what restricted purposes each group is intended to serve.
  - The church,
  - The nation,
  - The city,
  - The labor union,
  - The commercial association,
  - The club, etc.
- The reason we do so is that we **recognize wide variations** in the interests of members.

- Given these **variations**, members seldom have **identical preferences**, even about the **stated purposes** of the group itself, let alone about how to **accomplish** these purposes.

- **Consequently,**

**Social decisions** are not easily arrived at because they must **accommodate** the wide variations in members' **values and tastes**.

**How could groups accommodate social decision?**

**Unanimity (extreme case)**

no social choice is made unless **everyone agrees**

In the **Polish Diet**, where each person had a veto, facility in decision is said to have depended, occasionally, on defenestration of dissidents.

## ■ Dictatorship (extreme case)

**one person** decides for everybody.

The difficulty with a **dictator** is that, when he/she **ignores** the **values** of other **members**, they often infer that membership is itself no longer worthwhile.

In between these **extremes** of unanimity and dictatorship, groups **accommodate** to diversity by requiring only that **some intermediate** number, larger than one but less than everyone, be necessary for decision.

### Intermediate Case

#### coalitions

“An **organization** whose members commit to **an agreed-on purpose** and **shared decision making** to influence an external institution or target, while each member organization maintains its own **autonomy**.”

## For example,

- ✓ *A political coalition in favor of trade protectionism in USA*
- ✓ *Customer Coalitions in Electronic Markets*

In the last few years, the electronic marketplace has witnessed an exponential growth in worth and size. However, it witnessed a coalition formation as a means to achievement of economies of scale among customer agents in a form of “buying clubs” - groups of customers coming together to procure goods at a volume discount. In such case, customers build coalitions to strengthen their positions in the market. (Maksim Tsvetovat, *et al.* 2001)

## Political Finance

### The Relation between Money and Politics

- The transmutation of **economic power** into **political power** has been of historic concern.

➔ There exists inevitable **links** between **economic structures** and **political processes** through **political finance**.

#### How?

- ✓ This can be witnessed in the **political roles** of those engaged in funding candidates and political parties.
- ✓ And also, during **phases of the governing process**, e.g., in the persuasion of voters, in party nominating processes, in executive decision making.

#### ■ Aspects of Political Finance include:

- ✓ Cash transactions,
- ✓ Services or goods directly provided,
- ✓ Credits and other economic benefits extended or withheld,
- ✓ Public Subsidies.

## Private Development Financing

### Private Capital Flow

- Today, large volumes of global savings move through an increasingly **integrated global capital market** in search of investment opportunities.

➔ **Capital is abundant.**

- The developing world is receiving an increasing share of these flows, to the benefit of **private investment** – in production, trade and infrastructure – as well as to the **balance of payments**.

**Foreign Direct Investment (FDI)**

➔ **the most stable form of capital flow**

- FDI is concentrated on a narrow range of countries

**China Dominating**

- while FDI into the smaller economies is rising (in **Sub-Saharan Africa**), it remains confined mainly to its traditional destination – the **mining sector**.

**This benefits growth but leaves economies undiversified**

- Private portfolio flows into equities and bonds are still concentrated on a narrow range of emerging markets

**Flows into the ‘frontier markets’ is still small**

**Global investors** must also be sufficiently **risk-taking** to allocate a large enough share of their portfolio to the relevant asset categories to benefit significantly from any **superior returns**

- We can expect more use of **derivative instruments** by **global investors**

Forwards

Futures

Options

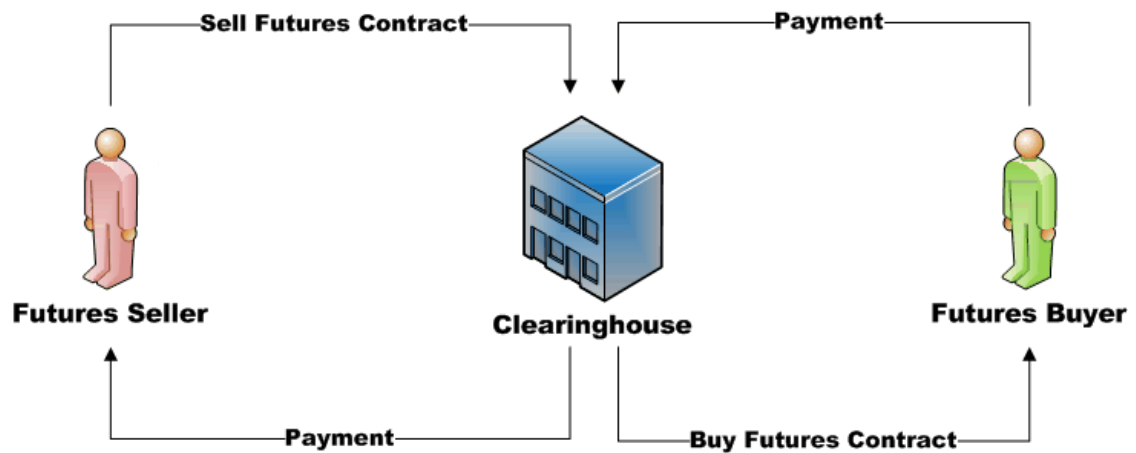
Swaps

to hedge currency and political risks;

- We can expect more use of **innovation** by **global investors**

to reduce the costs of such hedging, which could help in stimulating flows to **riskier countries**.

Note that: not all risks can be hedged



## FORWARD CONTRACT



10,000 LBS.  
@15¢   
IN 6 MO.

## FUTURES CONTRACT



10,000 LBS.  
@15¢   
IN 6 MO.

The political risks of investing in poor countries remain high

Because of insecure property rights

**Recipient countries** must:

- 1) improve **corporate governance** substantially to protect shareholder rights  
     **otherwise equity investment will not be sustained**
- 2) build better **sovereign-debt** management  
     **(a tough challenge for the poorer countries)**
- 3) improve their macroeconomic management to cope with the **real-economy** effects of the **capital inflows**.

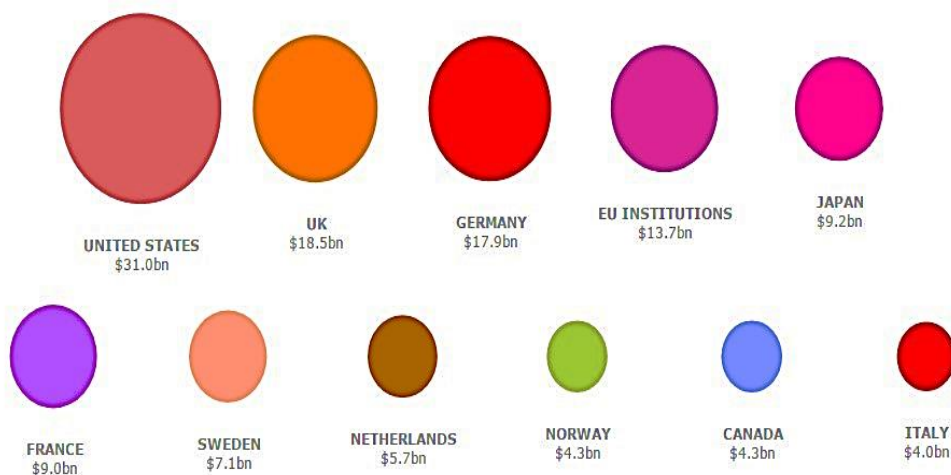
## ODA (Official Development Assistance ): Official Capital Flow

### What is ODA?

- loans to **developing countries** to promote economic development and welfare.
- The DAC defines ODA as “those flows to countries and territories on the DAC List of ODA Recipients and to multilateral institutions. These flows are:
  1. provided by official agencies, including state and local governments, or by their executive agencies; and
  2. Each transaction of which:
    - is administered with the promotion of the economic development and welfare of developing countries as its main objective; and
    - Is concessional in character.

### Who are the world's top donors?

Year 2015 | Currency: USD | Data source: OECD



## ODA from EU - Sectoral Distribution:

### ■ The main sectors that the aid from EU institutions and members is spent on are:

- Government and civil society \$7,716m
- Humanitarian Aid \$6,101m
- Banking and financial services \$4,691m
- Transport and Storage \$2,962m
- Education \$5,670m
- Agriculture \$2,630m

## What has EU aid achieved?

### ■ In the last ten years EU aid:

- Gave more than **31** million people access to **safe drinking water**
- Stopped 24 million from going **hungry**
- Gave more than 9 million children a **primary education**
- Equipped 2.1 million **rural people** with **modern energy services**
- Helped protect more than 1.5 million **hectares of forest**
- **Vaccinated** more than 5 million children against **measles**
- Supported 58 **election observation missions**

## The Politics of Austerity

- After a **credit crunch**, there was a strong economic case for **expansionary fiscal policy** to fill in the gap of **aggregate demand**.
- Politically, it can be hard to **push** a policy which results in more **government debt**.

There may be an economic logic to **Keynesian demand** management in a recession

but

A politician appealing to the need to ‘**tighten belts**’ and ‘get on top of debt’.

## International Trade War

- A trade war is when a nation **imposes tariffs** or **quotas** on imports and foreign countries retaliate with similar forms of trade protectionism.
- A trade war starts when a nation attempts to protect a domestic industry and create jobs.
- As it escalates, a trade war **reduces international trade**.
  - **In the short-run**, it may work. but
  - **In the long-run**, a trade war **costs jobs** and **depresses economic growth** for all countries involved.

It also triggers domestic **inflation** when tariffs increase the prices of imported goods.



Thank you