

Political Economics

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Introduction

Political economics studies situations that arise when there is **interaction** between **politics** and **economics**.

Politics: why?

Politics is exciting because people **disagree**. They disagree about:

- ✓ **How** should they live?
- ✓ **Who** should get **what**?
- ✓ **How** should **power** and other **resources** be distributed?
- ✓ **Should** society be based on cooperation or conflict?



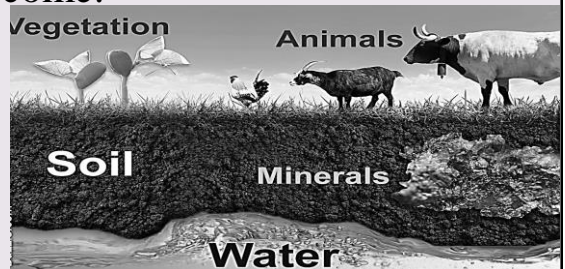
- ✓ **How** social conflicts should be resolved?
- ✓ **How** should collective decisions be made?
- ✓ **Who** should have a say?
- ✓ **How** much influence should each individual/ institution/ organization have?

Economics: why?

Economics is exciting because resources are scarce.

The basic questions of economics become:

- ✓ **What** to produce?
- ✓ **When** to produce?
- ✓ **How** to produce?
- ✓ **For whom** to produce?



Thus, the two Big (Main) Economic Questions

1. How do choices end up determining **what, how, and for whom** goods and services get produced?
2. When do choices made in the pursuit of **self-interest** also promote the **social interest**?

Other significant economic questions:

- ✓ **To what extent** should the government intervene in the market?
- ✓ **How** to define economic welfare?
- ✓ **To what extent** can the government / Central Bank influence the macro-economy?

We can observe that the main questions of politics and economics are interrelated.



What Is Political Economy?

- The phrase "**political economy**" has come to mean very different things in different places.

In political science departments,

➔ It means the study of how **economic forces** affect politics.

a Marxist implication

Since the theory emphasizes the importance of **economic forces** in explaining **political events**.

In economics departments,

➔ It means the study of **political forces** that affect **economic activity**.

It should be noted that:

- In **classical social philosophy**, the study of markets was not so **separate** from the study of **government**.
- The phrase "political economy" was taken from Greek words meaning "**housekeeping of city-states**," and it was applied to describe the study of how civilized societies are organized.
- So, the classical goal of political economy was to explain the functioning of all social institutions.



- The successful development of price theory forced a **separation** between:

The study of markets and The study of government.

Price theory describes market competition well, but it cannot be applied to **political competition**.

So, a **separation** of political science from economics was necessary when price theory was the **only** general analytical methodology in economics.

What is Price Theory?

Price theory is concerned with **explaining** economic activity in terms of the **creation** and **transfer** of value, which includes the **trade of goods** and **services** between different economic **agents**.

A puzzling question addressed by price theory is

‘Diamond-Water Paradox,’ Adam Smith (1776)

why is **water** so **cheap** and **diamonds** are so **expensive**, even though water is critical for survival and diamonds are not?

The word “value”:

- sometimes expresses the utility of some particular object “**value in use**”,
- sometimes expresses the power of purchasing other goods “**value in exchange**”

According to Smith, diamonds derive their value from their relative **scarcity** and the **intensity** of **labor** required to extract them.

Labor forms the basic unit of the exchange value of goods, which determines therefore their **‘real prices.’**

While, The **‘nominal price’** of an item is connected to the value of the currency used to trade it.



- Thus, economics has developed around a **core analytical methodology**,
- whereas **descriptive methodologies** have been more **dominant** in political science .

Recently,
with **game theory** alongside price theory, it makes less sense to separate the study of politics from economics.

- ✓ It is an **analytical methodology** that can be applied to political competition as well as to market competition.
- ✓ It allows theorists to recognize the **interconnections** between economic and political institutions.

For as such reunion:

- Economists have much to teach **political scientists** about the analysis of **incentives** in **competitive systems**.
- But **economists** need to learn from political scientists about what are good questions to ask about **political competition**.

➡ **how politics can affect economic variables**

The range of **explicit structural variables** that need to be analyzed is greater in political competition, because rules of political competition are written in constitutions and electoral codes.

Exercise_1: what are the main political determinants of economic growth?

Political Economy is about the effects of **political decisions** on **social** and **economic** development.

Poor people don't get an opportunity to improve their lives, then we should ask: what **institutions** and **interests** are impeding them from being better off.

- ✓ Who takes the decisions on **economic issues**?
- ✓ Who are the **winners** and **losers** of the economy?
- ✓ Why are **unequal distribution** and **poverty persisting**?



- A political economy perspective requires an **operationally useful set of tools** which links the economic **context** with **institutions, power** and **actors**.

These elements can be seen as **risks** or blockages to **effective policy reform** and **improved distributional equity**.



Thank you