CHAPTER 8

Political Economy

This is no game! On the (river) Liffey in Dublin, an artist's installation of Monopoly hotels and houses provides an ironic commentary on the collapse of Ireland's housing bubble.

LEARNING OBJECTIVES

8.1 Explain the role of the state in a nation's economy.

8.2 Determine the relationship among the separate elements that make up the political economy.

8.3 Assess the different measures of economic prosperity.

8.4 Compare the ideal-type political economies.

8.5 Identify the challenges faced by market, command, and mixed economies.

8.6 Contrast real world examples and ideal-type political economies.

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In the early 1970s, Ireland was primarily an agrarian economy and had one of the lowest levels of GDP per capita in Europe. The Irish government moved decisively to implement policies that would energize and transform the Irish economy. Most importantly, the government took steps to gain membership into the European Union (EU) in 1973. Among its other policies to reshape the economic sector, the government set the Irish corporate tax rate at an extremely low level of 12.5 percent to attract global companies and foreign direct investment. In addition, the government offered large government grants to encourage major global companies like Microsoft, IBM, and Ryanair to locate extensive operations in Ireland. Government agencies also provided financial incentives to stimulate the growth of small businesses and to encourage them to market their goods in the broader EU market.

The Irish government emphasized to national and global firms that Ireland had a well-educated and disciplined labor force that worked at low wages, compared to other EU members. It took advantage of EU grants to improve its educational system and to modernize its infrastructure. Ireland's National Development Plan vastly improved the transportation system, including enhancement of the roads and extension of fixed rail services. Deregulation of the financial sector made it considerably easier for the Irish to borrow money for purchasing consumer products and housing.

These strong government initiatives resulted in two decades of dramatic expansion and growth in the Irish economy. By the mid-1990s, the international business community, especially the high-technology sector, was substantially invested in the Irish economy, which was now known as the "Celtic Tiger." Between 1995 and 2000, the economy continued to expand at a very high rate, averaging 9.4 percent growth per year. Disposable income among the Irish soared and unemployment fell to 4.5 percent by 2007. Ireland shifted from a net emigration state to a popular destination for immigrant workers. Ireland was rated as the world's number one country in *The Economist's* quality of life index. In less than three decades, Ireland had blossomed from being one of the poorest countries in the EU to one of the wealthiest.

Then, in 2008, the Irish economic bubble burst. Many of the government policies that had spurred economic growth now contributed to a serious economic collapse. The government's deregulation of the financial sector, low interest rates, and lowered income taxes had stimulated an investment and buying spree. Public spending had increased 48 percent, there had been far too much borrowing, housing had become hugely overvalued, and many people, as well as the government, were now in serious debt. The government tried to cut back on its own spending to reduce its deficit and protect its credit in the Euro zone.

By September 2008, Ireland was the first EU country to fall into recession. Demand for goods kept dropping from both domestic and global consumers. Ireland's debt was judged to be the riskiest in the EU, worse than the debt in Greece. As the recession deepened, unemployment rose to 14 percent in 2010, and the IMF (International Monetary Fund) projected that Ireland's economy would contract by more than 10 percent. Under pressure to meet EU guidelines about deficits, the government was forced to reduce its spending even further. After bailing out its failing banks and cutting back on many popular programs such as subsidies for medical services and higher education, the Irish government negotiated a $90 billion bailout package funded by the IMF and the EU. Despite the aggressive policies of the Irish government to heal the economy, business and consumer spending continued to languish.

If one needed evidence that the economic system and the political system are completely intertwined in a modern society, the recent history of Ireland offers a compelling case. Both the period of Celtic Tiger economic growth and the serious economic problems now facing Ireland are extensively linked to the policies of the Irish government. Indeed, both the economic difficulties and the economic policy challenges currently facing many countries, including Great Britain, Greece, Portugal, Spain and the United States, are directly associated with their governments' policies. Thus, the distinguished scholar Charles Lindblom (1977: 8) observes: "In all the political systems of the world, much of politics is economics and most of economics is also politics. . . . For many good reasons, politics and economics have to be held together in the analysis of basic social mechanisms and systems."

This book is about the *political* world. But if Lindblom is correct, your understanding of contemporary politics requires an understanding of its pervasive linkages with economics. This *combination of politics and economics* is called **political economy**. This chapter explains this concept. First, it describes the connections between the economic system and the political system. Then it characterizes three different types of political economies: (1) the *market economy*, (2) the *command economy*, and (3) the *mixed economy*. Finally, it examines how these political economies are related to major "isms" in the political world, especially capitalism, socialism, and communism.

POLITICS AND ECONOMICS

8.1 Explain the role of the state in a nation's economy.

Many decisions made by the political system have significant impacts on the economy. Can you think of how the following government policies might affect the economy?

- The government does not construct or repair any highways and roads.
- The government owns all factories producing cars.

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- The government collects very high taxes on the profits of businesses.
- The government fully finances the provision of all medical services for all citizens.
- The government places no restrictions on the right of foreigners to enter and work in the country.
- The government controls the prices of all basic foods.

Similarly, the actions of major economic actors and the performance of the economic system can have major impacts on the political system, which depends on the economic system to generate income, goods, and services for the survival and prosperity of its citizens. For example, what policy responses might you predict from the U.S. government to the following economic situations?

- A lengthy nationwide strike by air traffic controllers
- Exceptionally high unemployment over many months
- The proposed sale of the country's largest automaker to a Chinese corporation
- The discovery that there is less than five years' worth of oil reserves within the country's boundaries
- Bankruptcy filings by two of the country's largest financial institutions

The more one reflects on modern societies, the clearer it becomes that "much of politics is economics and most of economics is also politics."

Understanding political economy requires a grasp of some basic economic concepts. This chapter describes a conceptual framework for the economic system that is similar in spirit to Easton's framework for a political system (see Chapter 5). The framework presents only some core ideas that have been simplified considerably. However, this discussion does involve complicated abstractions, so hang in there! (If you want the full treatment, take an introductory economics course, or read an introductory economics book such as Heyne, Boettke, and Prychitko [2010]. For a political science perspective, see Wilensky [2002: Ch. 2]).

A POLITICAL-ECONOMIC FRAMEWORK

8.2 Determine the relationship among the separate elements that make up the political economy.

The abstract model presented in Figure 8.1 is our starting point for understanding the idea of a political economy. The figure offers an extremely simple characterization of the way in which extraordinarily complex systems of production and exchange operate (see Baumol and Blinder 2011: Ch. 8; Miller 2011: Ch. 8).

Factors, Firms, and Households/Consumers

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In the beginning (according to this model), there are three kinds of important productive resources—the three major ***factors of production*** (A) (see Figure 8.1). *Land* means the ground plus any raw materials (commodities such as coal and bananas) on or in the ground. *Labor* is human productive input (our common understanding of "work"). *Capital* is the nonhuman productive input from other resources (especially financial resources, machinery, and technology). Each factor of production is controlled by an owner who, in the language of economics, is referred to as a ***household*** (B).

Some actor called a ***firm*** (C) attempts to acquire a combination of these productive resources (factors of production) in order to produce a ***good*** (D1). A good

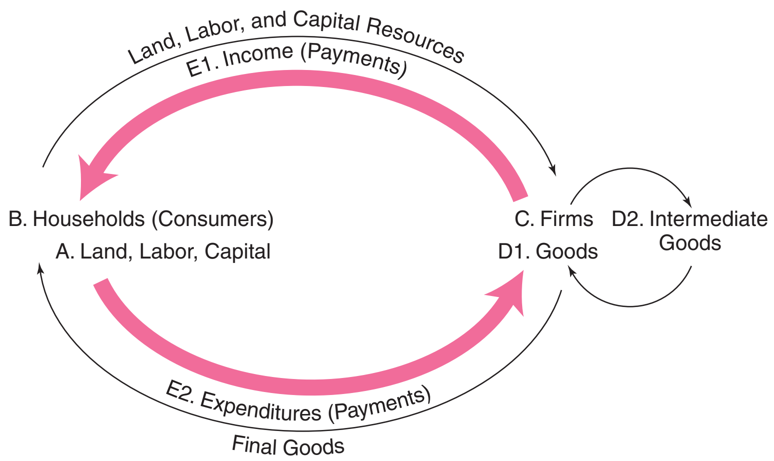

FIGURE 8.1
An economic system framework: the income-expenditures model

can be a product (e.g., a pencil, a nuclear missile) or a service (e.g., a massage, transportation on an airplane).

A firm (in this book, the terms *firm* and *producer* are used interchangeably) might be a single person who produces a good from her own resources. For example, a masseuse (massage giver) provides a massage through her own labor skills. Or a firm might be a large organization that uses many productive resources (of land and commodities, workers and capital). For example, a firm that produces something as simple as pencils needs productive resources such as wood, graphite, rubber, machines, and workers. The firm transforms these factors of production into the final good—here, pencils. Often some *intermediate goods* (D2) are acquired in order to make more complicated goods. The pencil firm, for example, has probably acquired intermediate goods such as graphite (which it acquires from another firm that has mined and refined this chemical element) and wood (which has come from a firm that owns, cuts, and mills trees).

A household has a second role, as a *consumer*, when it wants to acquire a final good (e.g., a pencil, a massage, whatever). A consumer offers something of value to the firm in exchange for the good that the consumer wants. What emerges between the household/consumer and the firm is a system of *payments* (E1 and E2 in the figure). A firm must pay something to a household that controls a productive resource necessary for the firm to produce goods. And a household, in its role as a consumer, must pay something to the firm to get a final good that it wants. Notice that any individual or group can act as a household, a consumer or a firm, depending on whether the individual or group is selling a factor, transforming productive resources into goods, or is acquiring a final good.

The size of a payment (the price) is established when there is an agreement between a consumer who is willing to exchange (give up) something to get the good and a firm who is willing to give up the good for what the consumer offers. In the language of economics, each actor increases her ***utility*** (her overall happiness) in such an exchange because each has higher utility after the exchange than before it.

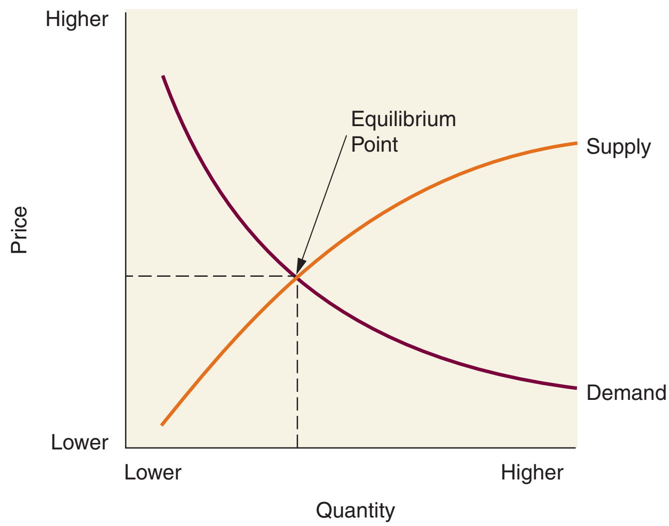

FIGURE 8.2
The relationship between the supply of a good and the demand for the good

So, for example, the actor who has grown a dozen tomatoes might have a higher utility when she exchanges them with someone who will give her something she values enough to give up the tomatoes.

In every system, there are some good-for-good exchanges, called *barter trading* (e.g., the dozen tomatoes are traded for a massage). But most economies are dominated by good-for-money exchanges, where the consumer gives the producer some amount of money in exchange for the final good (e.g., a tomato might be exchanged for $1, or a massage might be given for $50).

If firms want to sell more massages than customers want to buy, the price of a massage is likely to come down. This is how ***supply and demand*** operate: If demand is low relative to supply, the price comes down; if demand is high relative to supply, the price goes up. In theory, with enough producers and consumers making exchanges, the price of a good reaches a perfect balance point between supply and demand, known as the *equilibrium point* (see Figure 8.2).

The payment by a consumer to a firm (E2) is usually a different amount than the payments by the firm for the productive resources used to produce that good (E1 in Figure 8.1). A firm is successful if it can sell the good for more than it paid to produce the good. This excess of payments over costs is ***profit***. If the firm must sell the good for less than the cost of producing it, the firm suffers a *loss*. Obviously, firms normally try to increase their profit and to avoid loss.

Getting and Spending

This system of exchanges goes around and around. Households expend their resources on goods, and firms provide the households with income as they pay for productive resources. Ideally, everyone is exchanging things of value for other

The richest merchant in a Bedouin market in Morocco displays the goods she is selling, proudly wearing the chains of gold coins that attest to her entrepreneurial skills as a "firm" in a market economy.

things that they value even more. As the system becomes more complex, many actors are involved in the production and distribution of goods. Some additional actors operate as brokers, organizing and facilitating exchanges. For example, the grower of tomatoes might sell them to a broker, who then markets the tomatoes to other consumers. If more and more goods are produced, bought, sold, and consumed by all the actors in the economic system, there is ***economic growth***.

The complexity of the actual exchanges in most economic systems is beyond comprehension. As an example, see how long a list you can quickly develop of the different people who contributed some fraction of the value (the one dollar) that you pay for a can of tomatoes at the supermarket. (Think about all the actors involved in the production and distribution to you of that can of tomatoes) With sufficient time, you could probably identify hundreds of people who share in the dollar you paid.

Presumably, you (like every other actor) attempt to pursue a strategy that maximizes your utility (i.e., that results in your most preferred mix of goods and resources) and hence enhances your life. Individuals (and groups) have very different sets of preferences. One person might want to hoard money or food or precious metals; another might want to spend everything on consumption for personal pleasure. One person might work hard to gain the resources to own a mansion and a

Mercedes-Benz, while another person might be happiest with minimal work and no possessions other than the bare necessities she carries in a backpack.

Of course, it is a tough world, and all people are not equally capable of maximizing their value preferences. A person's success in getting her preferred mix of goods and resources can be affected by realities such as the types and amounts of resources she already controls, her skills in producing goods, the demand for her goods, the actions of other producers, and even luck. Over time, there are likely to be huge differences in the mix of goods and resources controlled by different individuals and groups.

The State Joins In

We now have our first approximation of an abstract model of the economic system. One very important addition to this simplified model is the political system. As noted at the beginning of the chapter, the modern economic system is inextricably connected to the political system. Why might the state decide to intervene in the economy? Here are a few of the most important reasons:

- there is a certain good that is socially important but no firm can produce it for a profit;
- there is a good that requires a scale of production beyond any firm's capacity (e.g., national defense);
- the state is needed to enforce legal behavior by households and firms (e.g., contracts);
- the state must protect people from dangerous or illegal goods or production techniques;
- the state has a policy goal of providing a good to some individuals who cannot afford it (e.g., health care);
- the state's goal is to redistribute goods and wealth from some individuals to others.

Notice that each subsequent rationale for state intervention on the previous list is driven more fully by a political value relative to an economic necessity (Lindblom 2003).

Thus, the state (F) is added in Figure 8.3, and these interactions between the economy and the state result in the dynamic processes we call the *political economy*. The state can powerfully affect the economic system in the six general ways, labeled F1 through F6 in Figure 8.3. The state can:

- be a consumer, purchasing any good from a firm. (F1)
- replace (that is, be) a household, in the sense that it controls certain factors of production. (F2)
- replace (that is, be) a firm, producing a good. (F3)
- regulate the manner in which either households or firms operate by enacting policies that encourage or prevent certain behaviors by those economic actors. (F4)
- tax (extract resources from) the payments to any actor. (F5)
- transfer payments or goods to any actor. (F6)

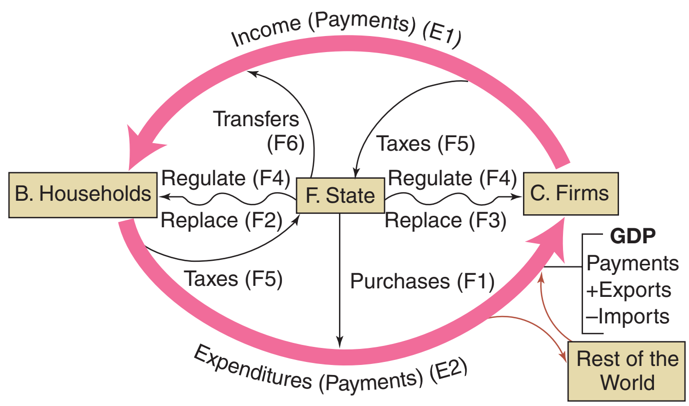

FIGURE 8.3
A political economy framework

The state's patterns of action on these six dimensions distinguish different types of political economies.

The World Joins In

The second important addition to our simplified model of political economy is nothing less than "the rest of the world." While Figure 8.3 could represent an economy at any level (e.g., a city), it is most commonly understood as the national economy of a state. It is quite likely that there are exchanges of goods and factors of production that cross the boundaries of the state. *All those goods and factors of production that are sold to actors outside the state's boundaries* can be considered ***exports***. Thus, if the tomatoes or automobiles produced in the United States are sold to households in Mexico, these exports generate revenue for U.S. firms (hence the plus sign in Figure 8.3). Exports are generally viewed as a positive for the economy, assuming the goods are sold for a profit, because they inject additional money into the system. Conversely, *the goods that a country's actors purchase from firms in another country* are ***imports***. Thus, if the United States imports tomatoes or automobiles produced in Mexico, these imports result in money leaving the U.S. economy (although the U.S. households and firms do get the goods).

Each country has major policy choices as it decides whether to influence the economic transactions that cross its borders. The state might be genuinely committed to "free trade" and thus make no effort to influence import and export activity. However, many countries do intervene in economic transactions that cross their borders in an attempt to serve their own national interests. Thus, the state can discourage imports by taxing them on entry (tariffs) or by limiting how much of an import is allowed (quotas). In some cases, the state might even encourage certain imports. Similarly, the state can implement policies that either facilitate or obstruct exports by its own firms. Can you think of reasons why a state might restrict certain exports or encourage certain imports?

There have always been economic exchanges the cross state borders. In the last few decades, however, the scale and complexity of interstate exchanges have become extraordinary. There is now a vast "global economy," and it is possible that there is more economic value in the economic exchanges that cross borders than in those that occur within countries. Chapter 11 will detail the forces of globalization, but the key point here is that states find it increasingly difficult to control their own economy. First, many firms now operate "multinationally," that is, they operate in multiple countries and can move their production from country to country, often very rapidly. Second, even more firms utilize factors of production and intermediate goods they have acquired from other countries. And third, most large firms now sell their goods in multiple countries. Thus, many consumers purchase goods whose productive factors are not primarily from their home country. For example, consider whether the clothes you are wearing or your electronics gear are goods in which the majority of components were produced by firms inside your country. Probably not.

The global economy has many consequences for the national political economy. States have much less capacity to regulate the behavior of firms, to control the balance of imports and exports, and even to tax many economic transactions. Thus, for most countries, the actions of firms and households outside the state's borders are very significant for the functioning of their political economy. The key impacts of such external actors will be particularly emphasized in Chapters 13–15.

The Economy Strikes Back

The previous discussion described how the state can implement a variety of policies that affect the economy. It is equally important to consider how the economy affects the state. A fundamental goal of every country is prosperity, and a healthy economy is the essential provider of resources to serve that goal. The state depends on the economic system to generate the goods and revenue that enable the state to function and its citizens to prosper. More than any other policy domain, governments flounder and fall when there are serious problems with the economy.

In most political economies, a substantial proportion of the activity in the economic system is not under the direct control of the state. Rather, there are many economic actors whose behaviors are of fundamental importance to economic health. The political economy is in trouble if unemployment is high, or a major firm is struggling, or state regulation is stifling economic growth, or high taxes are discouraging investment. Thus, those private sector actors with economic power can wield substantial, sometimes massive influence on the decisions and actions of the state. Moreover, some of those actors are among the most active and well-funded political groups, and they contribute money and employ lobbyists to shape public policies in ways that benefit their operations (Parenti 2010).

Who are the major sets of economic actors? First, there are the large corporations operating in the country. These firms are especially concerned about such policies as taxation, regulations on business practices and labor relations, and investment incentives. This group includes the flagship companies in the national economy, and their prosperity is directly linked to the prosperity of the country, psychologically as well as financially. There are also the multinational corporations with significant activity in the country. They have particular leverage with government officials because they can threaten to shift their productive activities outside the country if policies do not favor their operations. A second group is the country's small businesses. In most economies, these firms are the source of most job growth and are the heart of the overall functioning of the economic system, as they produce and distribute the bulk of the goods. A third set of actors is the interest groups that represent these various business communities and engage in substantial lobbying on their behalf. These interest groups are well funded and highly influential with government in almost every country, and in some countries (described below as "corporatist political economies"), the representatives of these organizations are actually direct participants in the policy process.

A fourth group of economic actors that are very powerful is composed of organizations in the global financial community. Some operate within a country—the banks and a broad array of institutions that have been termed the "shadow banking system" and that control financial capital (Lanchester 2010). Others are international financial institutions like the International Monetary Fund, the European Central Bank, and the World Bank, who can force major policy decisions on many governments, particularly those in the developing world, or in countries that are struggling financially, like Ireland. During the recent global recession and the financial crises in countries from Greece to the United States, these global financial actors, in concert with the banks, insurance companies, and brokerage houses, have been increasingly visible as the players whom governments placate and protect. In analyzing the collapse of bubble economies, the extent to which governments have allowed these actors to operate in dangerous ways and the willingness of governments to offer them protection (e.g., bailouts) has become much more evident than usual (Nouriel and Mihm 2011). Some critics argue that in almost every country, some combination of these powerful economic actors dominates governments far more than they are controlled by governments and by the economic policies of the state (Blustein 2006; Ritholtz 2009). At least, the deep intertwining of the economic system and the political system are indisputable.

MEASURING ECONOMIC PROSPERITY

8.3 Assess the different measures of economic prosperity.

Many analyses require a measure of the economic prosperity of a country. The most widely used indicators are usually based on one of two monetary figures that summarize "gross product"—the total value of all the final goods produced by a state's economic actors during a certain time period, adjusted for exports minus imports. ***Gross domestic product (GDP)*** is the total value of all final goods produced by all people within a state's boundaries, whether or not they are citizens (see Figure 8.3). The ***gross national income (GNI)*** includes the production of all citizens of the state, whether they are inside the state's boundaries or not. For cross-national comparisons, these amounts are typically measured in U.S. dollars. International economic actors have mainly utilized GDP as the primary indicator of a country's economic vitality, but in recent years, some have begun to emphasize GNI. Each has certain strengths as a measure of a country's prosperity in a global economy where there are increasing numbers of noncitizen workers and multinational firms.

Because both measures are greatly influenced by the size of the country, attempts to compare the relative prosperity of the people in different countries typically divide the productive total by the number of citizens (as "per capita"). However, as measures of a country's prosperity, both GDP per capita and GNI per capita have at least three important flaws:

1. They do not measure how the prosperity is distributed among the country's economic actors, and thus many citizens have an individual level of prosperity that is sharply different from their country's average production per capita. The level of wealth inequality *within* countries is a perennial hot topic, with some analysts claiming that it is a critical problem and others viewing it as an inevitable condition of a vibrant economic system. Compare in 8 and Figure 8.4 examine the level of inequality in selected countries.
2. Only the goods that actually enter the society's monetary sector are measured, while many other valued goods are ignored. These unmeasured goods include both household work and goods in the "underground economy," particularly trade in illegal goods, barter trade, and the black market. In some countries, GDP and GNI are particularly misleading because such unmeasured goods are a significant proportion of total economic activity.
3. GDP per capita and GNI per capita are often used to compare the prosperity of one country versus another. However, there are huge between-country disparities in the exchange value of money. In two different countries, the same amount of money (converting local currencies into an international exchange currency, usually dollars) can buy much more or much less of the same specific goods (e.g., a pound of rice in Japan might cost 20 times as much as in India).

Due to these cross-national disparities in the value of money, there is increasing use of a third prosperity measure that attempts to establish equivalent value across countries, an index based on ***purchasing power parity (PPP)***—that is, *correcting monetary indicators to reflect the amount of currency required in that country to buy certain standard goods.*

An understanding of the "average wealth" of citizens in a country, especially in comparisons between richer and poorer countries, is somewhat different depending on which measure is presented. If we use PPP indexing, Vietnam's GDP per capita of only $1,113 per year equates to $3,097 per capita in "purchasing power," nearly three times higher. In some countries, PPP lowers the wealth measure because the cost of living is high. The level of the GDP corrected for purchasing power in Denmark, for example, is actually only 2/3 of its GDP level. In purchasing power dollars, the economic gap between the wealthier countries and the poorer countries usually decreases. Thus in the case of Denmark and Vietnam, the ratio drops from about 50:1 to 11:1 when corrected for PPP. Indeed, for many of the poorer countries, GDP per capita (PPP) dollars are more than double the GDP per capita dollars. However, it is important to note that when a country attempts to participate in the global economy, and especially when it attempts to

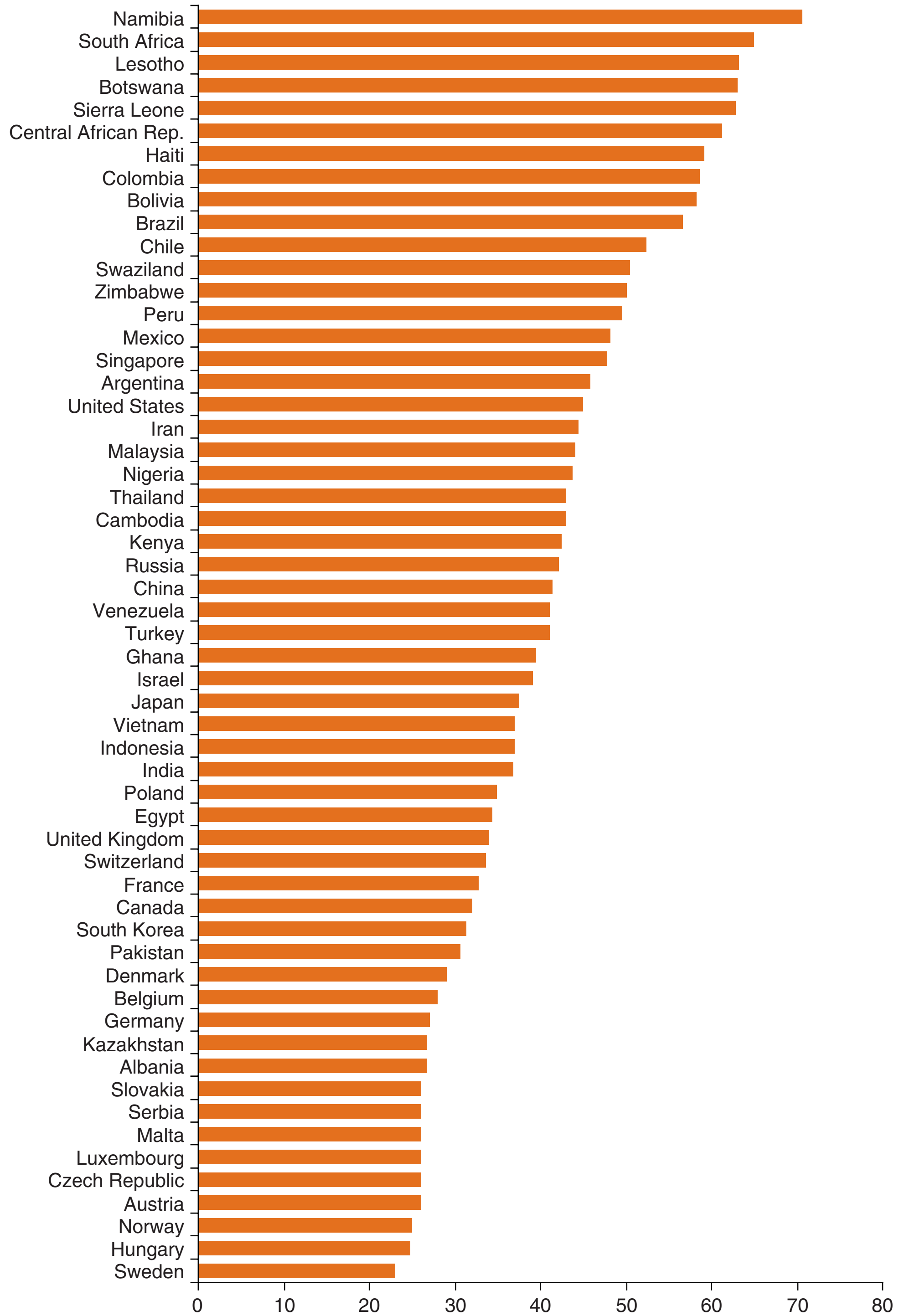

FIGURE 8.4

Wealth inequality/equality in selected countries (Gini index)

Source: CIA (2011)

import goods, the purchasing power of its currency is directly tied to international exchange rates, not to the price of rice at home (or PPP dollars), and its relative wealth or poverty remains.

More broadly, is there a better measure of the general prosperity in a society than GDP per capita (PPP)? Some scholars now argue that GDP-type measures give value to many economic activities in our collective lives that should not be valued, such as the cost of cleaning up environmental damage (e.g., oil spills) and expenditures on crime (e.g., maintaining prisons) and that GDP does not account for many things that do provide us with a higher quality life, such as volunteer service and environmentally sustainable activities. They also cite the recent findings of economists and other social scientists who conclude that beyond a limited level of wealth, human well-being correlates much more with conditions such as physical and mental health, quality of social life, and level of education rather than with increases in GDP per capita and material consumption (Easterlin 2006; Layard 2005; Frank 2001).

Thus, some propose an alternative measure, such as the "Genuine Progress Indicator" (GPI). The GPI adds the economic value of those things that enhance our quality of life and increase environmental sustainability and it subtracts the costs of those economic activities that reduce quality of life. While GDP per capita in the United States has risen about 240 percent during the period from 1950 to 2005, the Genuine Progress Indicator per capita has risen only about 25 percent. (Costanza 2008; www.rprogress.org). Another group proposes the "Happy Planet Index" (HPI), a measure for each country which combines individuals' reported satisfaction with their lives, longevity, and the country's ecological footprint (to protect resources for future generations) (Abdallah et. al. 2009). Do you think there is a case for a different measure of prosperity than GDP?

COMPARE IN 8 | Wealth Inequality

Chapter 2 identified the normative disagreements, especially between conservatives and socialists, about the desirability of equality. Many discussions focus on the inequalities in wealth between the "rich" countries and the "poor" countries. However, others focus on the wealth inequalities *within* countries. These can be masked by general measures of national economic prosperity per capita, such as GDP per capita (PPP). Are there significant inequalities within many countries? How are we to make sense of this?

Economic inequality (or equality) can be measured in various ways. One widely used measure is a statistic called the "Gini index." When used as a measure of income inequality, the Gini index computes a score in which a perfectly equal distribution of wealth in the population would equal 0.00, and a completely unequal distribution would have an index score of 100. As the Gini index is higher, and especially where it is greater than about 45, the wealth distribution is very unequal. The index also provides a way to compare the relative inequality across countries. Another form of measuring wealth within a country is the ratio of the country's personal income that is held by the top X percent of the population relative to the lowest Y percent.

(*Continued*)

Figure 8.4 provides Gini index score for selected countries among the 135 countries for whom there are data. Inequality in the distribution of family income ranges from the most unequal country, Namibia, with a Gini index score of 70.7, to the most equally distributed, Sweden, at 23.0. There are considerable cross-national differences in the extent of wealth inequality. About 28 percent of the countries have Gini indices of 45 or higher. Only 4 percent of the countries have scores above 60.0, 12 percent score in the 50s, 27 percent are in the 40s, 39 percent are in the 30s, and 15 percent are below 30 (CIA 2011). Of the ten most unequal income distributions, six are in sub-Saharan Africa and four are countries in Latin America. Of the ten countries with the most equal distributions, eight are in Europe and two are in Scandinavia.

It is generally the case that the rich countries (discussed as the "developed countries" in Chapter 13) have relatively *less* inequality in the distribution of wealth than most of the poorer countries (the "developing" countries in Chapter 14). Most of the countries with the greatest wealth inequalities are extremely poor countries. And most of the countries with the greatest equality in wealth distribution are countries that are European social democracies or European countries that were under communism until 1989 (Castles 2004). There are exceptions to this general pattern. Two rich countries (Singapore and the United States) have high inequality scores, while some poor countries (e.g., Ethiopia, Kazakhstan, and Pakistan) do have substantial equality in income distribution. An important issue to be addressed in later chapters is what general factors might account for greater or less equality in income distributions.

FURTHER QUESTIONS

1. Does the location of any country in Figure 8.4 surprise you? Why?
2. Why might there generally be more wealth inequality in poorer countries than in richer countries?

TWO IDEAL-TYPE POLITICAL ECONOMIES

8.4 Compare the ideal-type political economies.

Watch the **Video "China's New Rich"** at **mypoliscilab.com**

Based on the framework in Figure 8.3, we can distinguish two ideal-type political economies: *market economy* and *command economy*. Remember that an *ideal type* is a description of what a certain phenomenon might be like in its pure form, but it does not necessarily correspond exactly to any real-world example.

In distinguishing the market economy from the command economy, it's useful to consider five fundamental questions:

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

The next two sections consider these questions for each ideal-type political economy. Table 8.1 summarizes the responses to each of these key questions. The table also provides answers for a "mixed" economy, which is less an ideal type than a real-world compromise between the two. (For other approaches that explain political economy, see, for example, Heyne, Boettke, and Prychitko [2010] and Lindblom [1977, 2003].)

TABLE 8.1

Comparing Command, Market, and Mixed Political Economies

	Command	Market	Mixed
Who controls the factors of production?	The state owns all significant factors (land, labor, and capital).	Every private actor (household) controls her own factors.	The state and private actors each control some factors.
Who determines what goods are produced?	The state devises a detailed economic plan that specifies what level of each good will be produced.	All actors (firms) make their own separate decisions about production in an attempt to maximize their own utilities.	Some firms are under direct state control, but most make decisions in the market. The state regulates some actions of many firms and households.
	The system is supply-oriented.	The system is demand-oriented.	The system is mainly demand-oriented.
Who establishes the value attached to different productive factors and goods?	The state sets the value (price) in all exchanges.	The market (via the "invisible hand") sets the value based on the equilibrium of supply and demand.	The market sets the value. The state regulates some prices to serve national priorities.
Who decides how factors and goods will be distributed?	The state's plan indicates who will receive which goods and in what amounts.	Distribution is based on a summation of the actions of all consumers and producers in the market.	The market is the main decision maker. The state intervenes in some cases to ensure that certain actors have access to particular goods.
What is the role of the state?	The state is dominant, controlling almost all aspects of the political economy.	The state plays a minimal role in the political economy. The state enforces the "social contract," protecting all from violence or from law breakers.	The state attempts to strike a balance between: • competition and state control • private profit and a sharing of societal resources

The Market Economy: Total Private Control

1. **Who controls the factors of production?** In the ideal-type **market economy**, there is *total private control.* The state has almost no significant role in the political economy. Thus, every actor has direct, personal control over the use of all the factors of production that she owns. The laborer, the landowner, or the owner of capital decides who, if anyone, she will exchange her resources with and the amount of resources she will accept in that exchange. And each

firm acts to maximize its profits through acquiring productive resources and then producing goods that can be sold to consumers (Lindblom 2003).

2. **Who determines what goods are produced?** All the firms' decisions about what goods to produce are based on their own assessments of how they can achieve maximum profit. If one thinks of an economy in terms of the supply and demand for goods, the market economy is demand-oriented. The most important consideration for a firm that is deciding what to produce is this: What good can I offer that others will demand and that will generate the highest profit for me? Overall, production is guided by what the famous Scottish economist Adam Smith (1723–1790, Compare in 2) called the "invisible hand" of the market. This invisible hand is a summation of the self-serving actions of every household and every firm regarding their uses of the factors of production.
3. **Who establishes the value attached to different factors and goods?** Similarly, the invisible hand of the market establishes value. Every factor of production and every good that is produced is valued at its *opportunity cost*—the resources that someone will give to acquire it. Value is determined in the competitive market of supply and demand (recall Figure 8.2) as every household and firm tries to gain the maximum payment from others in exchange for its productive factor or good. Competition is particularly intense where supply and demand are quite unequal. For example, if a firm needs five workers who can program in C++ (demand) and only two workers are available with this skill (supply), the workers can bid up the resources that the firm will offer (this is usually a wage rate, but it can also include other resources such as work conditions, benefits [e.g., housing, health care], or shares of the firm's profits). Conversely, if five workers offer the skill and the firm needs only two workers with this productive factor, the firm can lower the resources it must pay for the work.

   A basic economic assumption in a market economy is the continual adjustment of supply and demand towards an equilibrium point. For example, some workers might move to a different place or offer a different labor skill if the wages for programming get too low or there are too few jobs. And a firm might find a substitute for the labor it needs if the labor is too expensive or too scarce to enable the firm to make a profit (e.g., outsourcing). Can you think of other supply–demand adjustments that the workers or the firm might make?
4. **Who decides how productive factors and goods will be distributed?** Again, it is the invisible hand of the market, rather than anyone in particular, that determines who gets which factors and goods. As each person pursues her own private utility, economic actors accumulate dramatically different bundles of factors and goods, depending on their preferences, the resources they control, and their skill and luck in exchanging and transforming resources in the market.
5. **What is the role of the state?** The state is passive in the productive system, allowing private actors to operate in a relatively unconstrained manner. The state's primary obligations, under the social contract, are to prevent private actors from doing violence to each other, to protect private property rights, and to defend the state's sovereignty. In meeting these responsibilities, the

state might purchase some goods and productive factors, might levy minimal taxes, and might affect firms' import and export activities. Otherwise, state intervention in the economy is extremely limited.

The Command Economy: Total State Control

1. **Who controls the factors of production?** In the ideal-type command economy, *the state assumes total control of almost all the significant factors of production.* The state eliminates private ownership of labor, land, and capital. The state owns the land, the natural resources, the factories, the machines, and so on. The state even owns labor, in the sense that the state decides the form in which all individuals will provide their labor.
2. **Who determines what goods are produced?** The state devises a detailed *economic plan* that specifies what goods will be produced, how much, and from what combination of productive factors. The production decisions in the state's plan are supply-oriented (in contrast to the demand orientation of the market economy). The state-as-firm attempts to use all productive factors optimally to maximize the supply of goods that it has determined are most appropriate to produce.
3. **Who establishes the value attached to different factors and goods?** Because the state controls all the factors of production and is the firm producing all the goods, it can also set the values (i.e., establish the payments) for all exchanges within its boundaries. Competition is eliminated because the state, rather than the market, establishes the payments for every factor of production and every good in the society. Thus, the state tells a group of farmers to produce 1 million tomatoes and then sets the exchange value of those tomatoes. Similarly, the state decides which individuals will have jobs programming C++, and it establishes the wages and benefits they receive for their work.
4. **Who decides how productive factors and goods will be distributed?** The state is particularly active in the decisions about the distribution of goods to the population. The state's plan aims to distribute an optimal bundle of goods to every citizen, given the resources available. Thus, the plan indicates who will receive which goods in what amounts. The plan could specify, for example, that automobile-producing factory X will receive 46 tons of steel each month, and that town A will receive three tomatoes per family per week. The plan can even indicate where these goods will come from (i.e., steel from factory Y and tomatoes from farm B).
5. **What is the role of the state?** Clearly, the answers to the preceding four questions indicate that the state has a dominant, even an overwhelming role in this ideal-type political economy. The state controls almost all the important factors of production, plans the manner in which they will be utilized in the production of goods, establishes the official value of all resources and goods, and decides how the resources of the society will be distributed among individuals. In the command economy, profit is accumulated by the state, not by individuals. The state then determines how this profit will be used to serve its objectives of prosperity, security and stability.

KEY PROBLEMS OF EACH IDEAL-TYPE POLITICAL ECONOMY

Table 8.2 lists several of the most important virtues of each of the two types of political economy. These benefits stem from the logic of each approach. In theory, the market economy is efficient and dynamic because profit-driven, self-serving behavior in a highly competitive environment encourages high levels of productivity and innovation. In theory, the command economy is effective and humane because society's resources are managed and distributed so that everyone benefits from the most desirable set of goods and services possible. These virtues are valid, at least in theory. However, there are significant potential shortcomings in the functioning of either the market economy or the command economy. These problems are also summarized in Table 8.2 and are characterized below.

8.5 Identify the challenges faced by market, command, and mixed economies.

Market Economy

Resource Inequality and Hardship Substantial resource inequalities tend to emerge in a market economy. Competition is everywhere, and it tends to become ruthless. In the economic marketplace, some are extremely successful and others

TABLE 8.2

Benefits and Problems of Market and Command Economies

	Benefits	Problems
Market Economy		
Competition	Energetic and efficient production	Ruthless interactions; huge inequalities in wealth and resources
Demand orientation	Goods' cost and quality responsive to consumers' desires	Creation of demand for and proliferation of goods that have limited social value
No central plan	Local decision and "invisible hand" stimulate innovation, facilitate freedom	Economic cycles of boom and bust, inflation and recession
Command Economy		
No competition	Work for common good; relative equality of wealth and income	Little initiative; shoddy products; low productivity; limited innovation
Supply orientation	Production and distribution for social and individual needs	Oversupply and shortages; lack of coordination
Central plan	Rational use of societal resources	Overcentralized control; lack of responsiveness to changing circumstances

are complete failures, and the market system is indifferent to the hardships of those who do not succeed. Neither the successful actors nor the state intervenes to protect those who have minimal success. Over time, the rich tend to get richer (especially if they cooperate with each other), while the less successful increasingly lack the resources for a secure and decent life.

Production for Profit, not Need A demand-oriented system of private production does not necessarily produce goods that best meet human needs. Rather, production decisions are dominated by actors who produce those goods that they believe will result in maximum profit ("greed is good"). Such goods might be inessential or extravagant or even dangerous. The state does little to regulate the economic actors or provide for those who cannot afford important goods, like health care. More broadly, the aggressive pursuit of profit in the absence of state regulation can result in economic behavior that is unethical or dangerous. And short-term profitability trumps longer-term considerations of societal benefits, such as environmental sustainability.

Severe Economic Cycles A third problem is that a market economy can experience major economic cycles. There is no guarantee that the very large number of private decisions about production and consumption (the "invisible hand") will mesh in a manner that ensures steady growth and prosperity for the economic system as a whole. The economy is prone to large swings towards either hyperactivity (causing inflation and scarcity) or serious economic slowdown (causing recession or depression), and the state does not intervene to counteract these swings. Fluctuations between boom and bust, even if infrequent, can be deeply disruptive to the productive system and the bad times can result in substantial hardship.

Command Economy

Limited Incentives for Efficiency The absence of competition in the command political economy can result in problems as serious as those resulting from excessive competition. First, if the state controls wages and prices, there are no major economic incentives for firms to be efficient, for managers to be innovative, or for individual workers to work hard. Second, if there is no competitive market of alternative goods, there is minimal incentive to produce goods of high quality. People are obliged to accept goods that are unexciting or poorly made.

Unresponsive Production The state's emphasis on a supply orientation means that production decisions are not directly responsive to consumer demand. The central planners' ideas of what people should want are not necessarily what consumers actually do want and will purchase. Thus, the plan typically results in substantial oversupply of some goods and severe shortages of others.

Overcentralization and Inflexibility Command economies are so centralized that they lose touch with the differences and complexities of individual firms and consumers. The central planners usually do not receive and react effectively to information regarding miscalculations and mistakes in either the development or the implementation of the state's overall plan. Such rigidity and unresponsiveness make

In many countries, inequalities result in slums and shanty towns packed with the poor that are often adjacent to the housing and office buildings of the prosperous, as in this *favel*a in Rio de Janeiro, Brazil.

the efficient use of productive resources unlikely. In short, the political economy that combines minimal competition, a weak demand mechanism, and inflexibility is prone to low productivity, inferior goods, and inefficient use of resources.

The Mixed Economy

Given the potential shortcomings of the ideal-type market and command political economies, is there an alternative? The **mixed economy** can be understood as *an attempt to combine the strengths of these two ideal-type economies while also minimizing their shortcomings*. As a hybrid, the mixed economy is not a "pure" ideal type. It compromises on each of the five major issues considered earlier (see Table 8.1).

1. **Who controls the factors of production?** Control of the means of production is shared between the state and private actors. The state owns or directly controls some of the major factors of production, such as those relating to key commodities (e.g., coal, oil, steel), key infrastructure systems (e.g., transportation,

telecommunications), and key financial resources (e.g., banks). However, many firms are private and private actors (households) control a substantial share of the factors of production.

2. **Who determines what goods are produced?** Production decisions are primarily demand-oriented, driven by the market mechanism. Half or more of all production is done by private firms. Most public-sector firms (those owned and managed by the state) must interact and even compete with many private firms when acquiring productive resources and when selling goods to consumers. However, private firms and households are constrained by the state, which regulates the behavior of private actors and can implement an economic plan that specifies broad guidelines for all actors in the economic system.
3. **Who establishes the value attached to different productive factors and goods?** The value of most goods is established, as in a market economy, through the processes of supply and demand. But the state does intervene to ensure that national priorities are protected. For example, the state might set guidelines to control the prices of key goods (e.g., basic foods, energy) and of certain factors of production (e.g., wages); it might regulate the manner in which firms and households collaborate and compete; and it might employ taxing and expenditures (purchases [F1] in Figure 8.3) to influence the economic system.
4. **Who decides how factors and goods will be distributed?** Decisions on the distribution of productive factors and goods are the most complicated element of the mixed economy. Private actors are allowed to take actions that maximize their profits. The state then intervenes through taxation mechanisms (F5 in Figure 8.3), extracting resources from firms and households. The state uses these taxes to purchase goods (F1) or to provide transfer payments (F6), both of which the state redistributes to certain actors in the social order. The state undertakes only a partial redistribution of resources, leaving private actors with considerable resources and freedom to make their own decisions about production and consumption.
5. **What is the role of the state?** The mixed economy, the state is far more active than in the market economy, but far less in control than in the command economy. The system blends a demand orientation and a supply orientation. The state's actions are to facilitate some competition while also mitigating the effects of ruthless competition, and to allow private actors and the economy to benefit from their skillful use of resources while also ensuring a certain level of necessary material well-being for the less successful actors. The great challenges for the state in a mixed economy concern striking a proper balance between competition and control, between a free market and a managed economy, and between private property and a sharing of society's resources.

All real-world political economies are mixed, as each attempts to find the best balance of market forces and state interventions. The search for such a balance is continual and in some cases impossible. Focus in 8 describes some of the challenges facing the Mexican political economy.

FOCUS IN 8 | Mexico's Political Economy

Since the Mexican Revolution of 1917, the economy of Mexico has experienced dramatic highs and lows as it has transformed from an agrarian system to a more diversified economy. Currently, about 63 percent of the Mexican labor force is engaged in the provision of services, 23 percent are in manufacturing, and 14 percent are in agriculture. The economy now generates about $13,900 per person (in PPP), ranking 70th among all countries (CIA 2011). The evolution of the economy is shaped by many forces, but two have been most critical.

The first force is Mexico's "geopolitical" situation—its natural resources and its geographic location (on geopolitics, see Compare in 11). Mexico has discovered abundant oil and other minerals, has considerable land suitable for farming, and has a long coastline on two oceans. Also, Mexico's economy operates under the looming presence of the United States, which is the largest and most influential economic system in the world, as well as being a political and military superpower. And to Mexico's south are the small countries of Central America, which have lower GDP per capita than Mexico and more commodity-based economies.

The second critical force shaping the economy has been the policies of the Mexican national government. Policy was dominated by a single party (PRI, recall Chapter 7) from the Revolution of 1917 until the 2000 election of Vicente Fox. PRI policies shifted the Mexican economy from a reliance on agriculture towards more balance and diversification through industrialization and then provision of services. State control and intervention in the economy were relatively high. The government owned large shares in major industries (e.g., energy, telecommunications) and regulated most key economic sectors. Its policies of high tariffs and subsidies to domestic firms protected both agriculture and industry from external competition. Labor was controlled to keep wages low, although some PRI leaders did promote state spending on social programs for the poor as well as some redistribution of land to the peasants. PRI was accused of extensive corruption that funneled considerable wealth from the economy to its members and to wealthy Mexicans. During the 1980s and 1990s, the government shifted away from state control and ownership of the economy, and towards more market-based policies, encouraging private entrepreneurs and opening the economy to foreign capital and imported goods. These policy changes were driven by severe economic crises in Mexico, including the near collapse of the peso, and by the general trends in the global economy.

The evolution of the Mexican political economy was accelerated when Mexico joined Canada and the United States in the North American Free Trade Agreement (NAFTA) in 1994. Mexico gained much greater access to the huge market for goods in the United States. More than 80 percent of its exports go to the United States. This includes oil, vegetables and fruits, and manufactured goods, many of which are produced in plants (*maquiladoras*) located near the U.S. border. Most of these plants import components (intermediate goods) from the United States and then complete the assembly of final goods that are exported, such as automobiles and televisions. The Mexican economy has grown in most recent years, with increasing rates of job creation, home ownership, and business start-ups, and with many families rising to the middle class. Greater prosperity has been associated with reduced birth rates and improved tax collection by the government.

NAFTA has also resulted in some negative effects in Mexico. For example, many agricultural products are now imported from the United States because they are cheaper (due to more efficient technology and U.S. government subsidies to its producers). This has increased unemployment and poverty among Mexican farmers. Also, the Mexican economy has become so dependent on the health of the U.S.

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economy that the recent economic problems in the United States have generated even deeper problems in Mexico, in areas such as job losses, obtaining financial capital, and currency value.

Illegal immigration, high levels of violent crime, and a burgeoning drug trade are also linked to Mexico's stronger economic ties to the United States. And while the areas close to the U.S. border have enjoyed most of the benefits from trade within NAFTA, many people in central and southern Mexico have experienced a decline in their living standards. Inequality has grown in Mexico with the market-based economy of the NAFTA period. But the recent national governments led by fiscally conservative presidents Fox (2000–2006) and Calderon (2006–) have not promoted increases in government aid to the poor and others affected by the economic decline. PRI might direct more resources to the less advantaged groups now that they have regained power in the Chamber of Deputies (recall Figure 7.2). The evolution of Mexico's political economy will be a key factor in its progress as a transitional developed country (see Chapter 15).

FURTHER FOCUS

1. What seems to be the most serious problem for the Mexican political economy? How might it be dealt with?
2. Does it seem more beneficial or harmful for Mexico to have the United States as its neighbor?

POLITICS PLUS POLITICAL ECONOMY: THE OTHER "ISMS"

The Three "Isms"

8.6 Contrast real world examples and ideal-type political economies.

Watch the **Video "Zimbabwe's Economic Crisis"** at **mypoliscilab.com**

One set of great "isms" in political analysis includes the Western ideologies of conservatism, classical liberalism, and socialism (see Chapter 2). Another set of "isms" explicitly links politics to political economy: capitalism, communism, and socialism. In 20th-century politics, these were extremely emotive labels, endowed with powerful ideological content. In their most straightforward form, capitalism, communism, and socialism correspond loosely to market economy, command economy, and mixed economy, respectively.

Capitalism is *a system in which private economic actors are quite free from state constraints, private property rights are fundamental, and the state engages in few actions that might shift resources among private actors.* It is founded on the philosophy of laissez-faire economics celebrated by Adam Smith, and it imposes the severe limitations on government activity that are associated with classical liberalism and the market political economy. The freedom of private economic actors is paramount, and the state should not intervene to benefit either winners or losers in the economic competition. There is no assumption that capitalism requires any particular form of political processes (e.g., on the democracy-nondemocracy continuum) to function efficiently (Thurow 1997). Singapore and Switzerland are examples of mainly capitalist systems.

Communism has as its centerpiece *the socialization of resources—the notion that the state must control society's land, labor, and capital to achieve substantial equality for all citizens.* Consistent with the command political economy model, the state guides the utilization of all these major means of production with a central plan so that the production and distribution of goods serve the best interests of the entire population. However, communism also emphasizes a strong ideological commitment to economic and social equality among all its citizens. And it typically posits that government and politics, like the economic system, must be guided powerfully by a unified leadership, at least until equality is achieved. Communism is generally associated with the theories of Karl Marx and with the economic systems that were developed in countries such as China (1949 to about 1990), Cuba (since 1959), North Korea (since the early 1950s), and the former Soviet Union (1917–1991).

Socialism is in the middle of the three "isms," and thus it is not precisely differentiated from the other two. It seeks *a complex balance between state involvement and private control of the economy and a key policy goal is a relatively equitable distribution of benefits to all citizens.* In common with the mixed political economy, some major productive resources are owned or controlled by the state, and the state actively intervenes in planning and regulating the economy; but most production decisions are private, and value is established primarily by supply and demand (Przeworski 1985). Sweden and Denmark are examples of what are known as democratic socialist systems (or "social market" systems; see Chapter 13) because they blend socialist economics with democratic politics. Socialism is distinguishable from communism because it only controls a few important factors of production in the society, allows private actors considerable freedom of action, and does not aim to achieve total economic equality among all citizens.

Socialism can be a confusing term because Karl Marx (recall Chapter 2) and most Marxist theorists use the terms socialism and communism in a different manner than either most contemporary Western commentators or the political economy approach of this book. In Marxist theory, communism is a higher stage of political economy that follows socialism. Marxists posit that during the socialist stage, the state strives to achieve social control of resources (the means of production) by eliminating private property. As private property is eliminated, the substantial inequalities between different classes of citizens are reduced. (A detailed description of the class approach to explaining politics will be provided in Chapter 9.) Communism emerges only when multiple classes (and the inevitable conflict between those classes) cease to exist. In the classless society, everyone works for the good of all, not to gain private value. Thus, most Marxists acknowledge that no "socialist" state (e.g., Cuba) has yet completely eliminated classes and the class struggle; in this sense, communism remains a goal.

This book employs the common Western usage: A society is termed communist if a state has nearly total control over the major factors of production and the politics tend towards totalitarianism. Given the recent shift away from communism (see Chapter 15), only a few contemporary states (e.g., North Korea) meet this criterion. Indeed, given all the failures of communist systems in recent decades, some suggest that communism is dead. The Debate in 8 considers this proposition.

The Real World

No contemporary country has a political economy that corresponds exactly to either the market economy or the command economy. Because these are ideal types, this fact is not surprising. While it is possible to locate countries generally along

THE DEBATE IN 8 | Is Communism Dead?

In the decades after World War II, many thought that Marx's prediction of the inevitable success of communism was correct because more and more countries adopted its main guidelines for their political economies. Soviet Union leader Nikita Khrushchev famously announced in 1956 that communism would bury capitalism. However, the Cold War between the communist Soviet bloc and the capitalist bloc led by the United States ended in the late 1980s with almost every country abandoning the command political economy, even the Soviet Union. While many note the triumph of capitalism over communism (Fukuyama 1992; Heilbroner 1994), the global economic meltdown has revitalized the Marxist perspective (Panitch 2009). Is communism, as a model for a political economy and a society, dead?

COMMUNISM IS DEAD . . .

- The command political economy that drives communism has stifled the incentives for productivity, innovation, and flexibility, in every country that has implemented it. These fundamental weaknesses resulted in failure and abandonment of this approach almost everywhere, from the Soviet Union and Eastern Europe to wherever it was attempted in Africa, Asia, or Latin America.
- Even most countries that are still "nominally" communist actually practice capitalism. For example, China protects its one-party political system, but it has freed its markets and many of its firms in order to benefit economically from global trade. In a radical departure from Marxist ideas, the Chinese "Communist" Party protects property rights and promotes wealth accumulation. Of more than 180 countries, the only countries that still practice something close to communism in political-economic terms are a very few small, economically backward states like Laos and North Korea.
- The attempt to create a population that truly believes in the communist ideology of collective sharing of societal resources and the equal distribution of benefits has repeatedly failed. Despite massive efforts at political socialization and substantial use of coercion by the state, human nature seems to prevent people from genuinely embracing the ideals of collectivism and egalitarianism.
- In retrospect, it is clear that the viability and spread of communism during the cold war (1945–1990) occurred primarily because communist countries could wield extensive coercion against their own populations and possessed formidable military power to promote communism abroad.
- Consider the well-known European aphorism: If you are not a communist at 20, you have no heart; if you are still a communist at 40, you have no brain (an observation even repeated by Russia's top leader Vladimir Putin in 2007). Political and economic power in the world is clearly dominated by older and wiser people who, almost without exception, completely reject communist ideas.

COMMUNISM IS ALIVE AND WELL . . .

- Numerous countries still operate under the general principles of a command political economy. The strong, one-party state controls the political economy and opens it to the market only to the extent that the market furthers the key communist aims of using society's key resources to increase the broad sharing of benefits. This is the case in countries in European Central Asia (e.g., Belarus, Tajikistan, Turkmenistan, Uzbekistan), Asia (e.g., Cambodia, Nepal, North Korea, Laos, and Vietnam), and Latin America (e.g., Cuba).
- In countries that have "abandoned" communism, a substantial proportion of the population still prefers their circumstances under communism to those in the postcommunist period. In Russia, for example, four-fifths of those surveyed in 2001 said that they wished the old Soviet Union still existed (Peterson 2001). Similarly, some

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of China's rural population not only opposes capitalism's exploitation, but supports equal property distribution (Nadiri 2007).

- Democracy and communism are not incompatible. In fact, several democratic countries have or recently had majority communist party governments—Cyprus, Moldova, and Nepal. In democratic India, three states have recently been dominated by the communist party, including 34 straight years in West Bengal (Williams 2008).
- The key principles of communism, especially the collectivization of major societal resources and redistribution of wealth towards the less advantaged, are very evident in the political philosophies of leaders such as Evo Morales in Bolivia, Daniel Ortega in Nicaragua, Jacob Zuma in South Africa, and Hugo Chavez in Venezuela, as well as some European leftist parties with solid electoral support.
- Insurgency movements inspired by communist ideals are still active in some countries that suffer from economic underdevelopment and severe inequalities. This includes movements in Colombia, India, Peru, the Philippines, and Turkey.
- Reconsider: If you are not a communist at 20, you have no heart. . . . The majority of the world's population is young, poor, and suffering from the severe inequalities in their own societies. It is not surprising that many of them are attracted to the fundamental values of an ideology that promises economic and social justice.

MORE QUESTIONS . . .

1. Is it possible that the ideals of communism will always appeal to at least a minority of people in countries experiencing high levels of poverty and inequality?
2. Is the repeated failure of the command political economy due to "clumsy implementation" or its inherent flaws?
3. Is a relatively classless society possible, or will there always be inequality?

a continuum from a "pure" market economy to a "pure" command economy, all actual political economies are mixed. This does not mean that all political economies are basically the same—the mix of elements varies a great deal from country to country. Every state engages in some activities as a firm, some regulation of economic actors, and some redistribution of resources. Politics and values play a powerful role in establishing exactly what kinds of interventions the state will undertake and what values and interests the state will serve. Thus, understanding the mixed nature of actual political economies entails more than simply comparing the proportion of the GDP controlled by private actors versus the state or even measuring the bundle of state-provided goods and services.

In contemporary political discourse, the labels of capitalism, socialism, and communism are often presented in an ideological context. To their advocates, each represents the best mix of political and economic strategies to achieve a desirable society. To their critics, they describe undesirable *sociopolitical* orders. Communism, for example, is disparaged as an inefficient economic system with a nondemocratic government that denies individual freedom and rights. And capitalism is maligned as a system of self-interested individualism that denies the need for collective action to protect the disadvantaged or to nurture society as a whole, to promote social values and culture, or to protect the ecology (Heilbroner 1994).

Every "ism" considered in Chapter 2, from anarchism to totalitarianism, includes assumptions about appropriate forms of political economy. One "ism" that is explicitly linked to many contemporary political economies is ***corporatism***, a system characterized by *extensive economic cooperation between an activist state and large organizations representing major economic actors*. The corporatist state attempts to consult, cooperate, and coordinate with the representatives of several key groups that control major productive resources in the society. These "peak associations" (organizations that represent these big groups) usually include large industries, organized labor, farmers, and major financial institutions. The peak associations have some autonomy from the state, but they are supposed to work together for common national interests. Thus, corporatism blends features of capitalism (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). Brazil, France, Japan, Peru, Portugal, and Spain are among the contemporary states that still have significant corporatist tendencies (see Crouch and Streeck 2006; Schmitter 1993; Wiarda 1997, 2004).

The four examples that follow—Switzerland, South Korea, Denmark, and Cuba—briefly suggest some of the features of actual political economies, relative to the ideal types grounded in the major "isms" presented above (Data sources are CIA 2011; Heritage Foundation 2011; Transparency International 2011; UNDP 2011).

Generally Market and Capitalist: Switzerland The fourth wealthiest major country in the world (measured as GDP per capita in purchasing power parity), Switzerland has a relatively weak central government. This decentralization of political power is linked to a political economy that strongly emphasizes private control and limited government involvement. Switzerland is ranked fifth among 178 countries on a measure of freedom of the economy from state regulation (Heritage Foundation 2011). Nearly all factors of production are privately owned, and most decisions and actions regarding the use of those resources are in private hands. Apart from defense expenditures and education, relatively few resources are allocated to the provision of public goods, given the wealth of the society. Central government spending is less than 15 percent of GDP, and total expenditure by all levels of government is 32 percent of GDP, among the lowest of all developed countries. Although still low, welfare spending rose substantially in the 1990s, generating a national debate about limiting public expenditure on social programs.

Generally Mixed and Capitalist: South Korea In South Korea, the state has little commitment to use the political economy for direct improvement of its citizens' quality of life. Apart from education, the state does not provide many welfare goods and services to its citizens. Government expenditures (by all levels) are only about 28 percent of GDP, the lowest among all relatively developed countries. It is not a purely capitalist system, however, because the state is extremely interventionist in promoting economic development. The state bureaucracy works very closely with firms to implement a comprehensive, collaborative strategy for economic growth, helping it to rise to thirty-second in the world on GDP per capita. This strategy has particularly favored the development of a few major Korean companies. Government loans, tax credits, and other subsidies are channeled to these companies, which are expected to operate and diversify in directions suggested by the government. In turn, the government has assured the companies that they will enjoy high profits and a labor force that is well educated, disciplined, and unable to organize effectively for higher wages. The state has also used many hidden subsidies and import restrictions to provide competitive advantages in the international market to its export-oriented firms. Thus, South Korea ranks only thirty-fourth on the measure of economic freedom. (This "developmental-state" approach, another political economy mix of state and private sector, will be discussed further in Chapter 10.)

Generally Mixed and Socialist: Denmark Denmark is ranked sixteenth among major countries in terms of GDP per capita (PPP). The great majority of productive resources in Denmark are privately owned, and the state allows entrepreneurs considerable freedom of action, with a ranking of eighth on the economic freedom measure. However, the state is very active in guiding the Danish political economy. First, it enforces strong policies that regulate private economic actors in a generally corporatist approach, especially policies that control working conditions and environmental quality. Second, the state provides an extensive array of welfare services to the population, including: income supplement programs; a comprehensive, free health care system; state-subsidized housing for the elderly and for low-income groups; free child care; free education from infancy through university; and an extensive public transportation system. Third, it has one of the world's most equal income distributions and is ranked the world's least corrupt country. More than 51 percent of GDP is spent by all levels of government, the second highest among developed countries. To finance these programs, the government collects various forms of taxes equal to more than 50 percent of the GDP.

Generally Command and Communist: Cuba In response to the global movement towards more market-oriented systems, Cuba has reduced its level of centralized state control over the economy. However, the state still owns and controls Cuba's major means of production, and there is a detailed central economic plan. Cuba is ranked 176 among the 178 countries on economic freedom. Agriculture and manufacturing operations remain collectivized, and the state controls many prices. The state promises work for all (although there is unemployment), and it sets workers' wages. Consistent with the ideals of communism, the state retains a fundamental commitment to control and allocates societal resources to serve human needs. There has been a strong emphasis on state spending on education and health care and on policies to equalize the distribution of land and income in order to increase equality among races, between genders, and between urban and rural citizens. Despite its rather low GDP per capita (it ranks 93 in the world), government policies result in Cuba ranking in the top 15 countries in the world on the UN "nonincome" measure of quality of life that emphasizes health and education (Human Development Index) (see Chapter 13).

CONCLUDING OBSERVATIONS

Study and **Review** the **Post-Test & Chapter Exam** at **mypoliscilab.com**

This chapter has introduced you to an approach to political analysis that classifies and characterizes countries in terms of their political economies. These concepts are abstract and require the fusion of political science and economics. They are important concepts because the linkages between the political system and the economic system are fundamental and pervasive in the contemporary world. Indeed, the two systems have become so interrelated in most states that it is difficult to separate them, except in an analytic sense. There is substantial variation in the extent to which the state intervenes in the economy. In some countries, the state's role is limited, while in others the state is deeply involved in most aspects of the production and distribution of goods. Regardless of the form of the political economy, the health of its economy is crucial to every state and the impacts of the economy and economic interests on government and politics are enormous.

In considering communism or capitalism, you might find it difficult to avoid strong normative judgments due both to your political socialization and to your tendency to identify an "ism" with particular states for which you have definite positive or negative feelings. In the United States, "tea party" activists are outraged by the "socialist" policies of President Obama. In Bolivia, President Morales claims that "(t)he worst enemy of humanity is U.S. capitalism." It is certainly reasonable that you will make both analytical *and* normative judgments about the virtues and shortcomings of every form of political economy and every "ism."

Indeed, assessing the appropriateness of a country's political economy might be the most crucial issue in understanding its effectiveness in the contemporary political world. In recent years, the support for communism and the command political economy has substantially declined among the leaders and citizens in many countries. As you will see in Part Five, however, that decline has not necessarily led countries to adopt a full implementation of a market economy. It has not even meant that most political leaders and most citizens have abandoned their support for all of the principles associated with a more command-oriented political economy or more extensive redistribution of wealth.

Despite your own political socialization, you might reflect on a fundamental question: Is *every* state, regardless of its current economic and political development, best served by exactly the same political economy? If you allow for variations in the most appropriate form of political economy for countries in the current global system, you leave open many challenging and important questions about political choices, questions that will be considered from a variety of perspectives in the remainder of this book. This exploration will begin in Part Four, with chapters that examine crucial issues associated with political decision making; political, social, and economic change; and political violence.

KEY CONCEPTS

capitalism 220
command economy 214
communism 220
corporatism 224
economic growth 203
exports 205
factors of production 200
firm (producer) 201
good 201
gross domestic product (GDP) 207
gross national income (GNI) 207
household (consumer) 200
imports 205
market economy 212
mixed economy 217
political economy 199
profit 202
purchasing power parity (PPP) 208
socialism 221
supply and demand 202
utility 202

FOR FURTHER CONSIDERATION

1. The economic productivity of command political economies has always been inferior to that of market political economies in comparable countries. What, then, might have been the attraction of this approach to many groups and to many countries between the 1950s and 1970s?
2. What would be the greatest benefit to individuals if the state played almost no role in its political economy? What would be the most serious problem with such a system?
3. Are there measures, other than the growth in GDP per capita, that might indicate the success of a political economy? Why are leaders in most states so worried if there is no growth in GDP per capita?
4. Do you agree with those who contend that capitalism is so individualistic that it fails to protect the collective good?

FOR FURTHER READING

Courtois, Stephane, Nicholas Werth, Jean-Louis Panne, Adrzej Paczkowski, Karel Bartooek, and Jean-Louis Margolin. (1999). ***The Black Book of Communism: Crimes, Terror, Repression.*** **Trans. Jonathan Murphy and Mark Cramer. Cambridge, MA: Harvard University Press.** A detailed and profoundly critical analysis of the history of communism in the 20th century. Its core argument is that a series of regimes and ruthless dictators (e.g., Lenin and Stalin in the Soviet Union, Mao Zedong in China, Pol Pot in Cambodia, Kim Il Sung in North Korea) have led communist regimes that engaged in brutal "class genocide" in their societies, resulting in as many as 100 million deaths.

Friedman, Milton. (1981). ***Capitalism and Freedom.*** **Chicago: University of Chicago Press.** The major contemporary explication of the classical liberal preference for a strong market economy with only limited state intervention.

Garson, Barbara. (2003). ***Money Makes the World Go Around.*** **New York: Penguin.** The controversial social critic offers a wonderfully readable exploration of the global economy by tracking the money in two small investments and revealing how that money has various effects on people around the world.

Heilbroner, Robert. (1994). *Twenty-First Century Capitalism*. New York: W. W. Norton. An economist and social critic outlines the challenges facing capitalism and the continuing need for the state to guide the market economy and serve the social good.

Judt, Tony. (2010). *Ill Fares the Land*. New York: Penguin Press. Writing to "young people," this major scholar of social history offers an eloquent argument for the values of social democracy—collective action for collective good—in contrast to the ideology of capitalism and self-interest that dominates current thinking in the most prosperous countries and is, he argues, dangerous and destructive.

Kristol, Irving. (1978). *Two Cheers for Capitalism*. New York: Basic Books. A leading U.S. neoconservative argues that capitalism is superior to alternative forms of political economy.

Levitt, Steven D., and Stephen J. Dubner. (2010). *Super Freakonomics: Global Cooling, Patriotic Prostitutes and Why Suicide Bombers Should Buy Life Insurance*. New York: William Morrow. And now for something completely different: Like the earlier **Freakonomics** (2008), this book offers a playful and interesting wander through microeconomics, revealing how economic thinking can explain the impacts of incentives and public policy on individual and group behavior and (often) generates unexpected outcomes.

Lindblom, Charles E. (1977). *Politics and Markets: The World's Political-Economic Systems*. New York: Basic Books. A rich, comparative analysis of the relative merits of the political economies of modern socialism and capitalism.

Reisman, George. (1998). *Capitalism: A Treatise on Economics*. A lengthy but powerful and readable defense of laissez-faire capitalism, debunking myths about its weaknesses and critiquing rival theories, from Keynesianism to communism. Available free online at www.capitalism.net/Capitalism/CAPITALISM_Internet.pdf.

Ritholtz, Barry. (2010). *Bailout Nation: How Greed and Easy Money Corrupted Wall Street and Shook the World Economy*. New York: Wiley. Blogger and money manager Ritholtz offers a scathing and highly controversial indictment of both government policy and the behavior of profit-driven financial actors that led to the recent global economic crisis.

Roubini, Nouriel and Stephen Mihm. (2011). *Crisis Economics: A Crash Course in the Future of Economics*. New York: Penguin. A reasoned analysis of the interplay between the economic system and the political system that explains how problematic behavior of actors in both domains caused recent financial crises in many countries and must be altered or there will be an even bigger crisis soon.

Royo, Sebastian. (2002). *"A New Century of Corporatism?" Corporatism in Southern Europe—Spain and Portugal in a Comparative Perspective*. Westport, CT: Praeger. Detailed case studies of the last three decades in Spain and Portugal are the basis of an exploration of how technological and postindustrial changes have created the conditions for a resurgence of corporatism in European settings.

Westoby, Adam. (1989). *The Evolution of Communism*. New York: Free Press. A thorough and illuminating history of the development of communist thought and practice.

Yergin, Daniel, and Joseph Stanislaw (2002). *The Commanding Heights: The Battle Between Government and the Marketplace That Is Remaking the Modern World*. Rev. ed. New York: Simon and Schuster. A sweeping, readable account of how major countries in Europe, Latin America, Asia, and North America embraced extensive state intervention in their political economies in the period after World War II and then shifted from the mixed economy towards a stronger form of market economics.

Yunus, Mohammed. (2010). *Building Social Business: The New Kind of Capitalism that Serves Humanity's Most Pressing Needs*. New York: PublicAffairs. Nobel Prize winner for his innovative microcredit strategy (see Focus in 14), Yunus offers his vision of a model of "social business" which blends free market entrepreneurialism with a focus on meeting social needs.

ON THE WEB

http://imf.org

The key documents and agreements among all states and for particular members of the International Monetary Fund (IMF), an organization that includes more than 180 countries that cooperate to sustain a smoothly functioning system of interstate trade and to provide loans and other financial assistance to countries.

http://freetheworld.com

A site containing reports and data from the Economic Freedom Network, a congeries of researchers "committed to bringing economic freedom and growth to all the countries of the world."

http://www.marxists.org

The Marxists Internet Archive offers links to numerous sources that make the case against capitalism as an economic system.

http://worldbank.org

The official site of the World Bank, an international consortium of banks and other major financial institutions, includes extensive economic data regarding the structure and performance of the economies of more than 180 countries.

http://www.wto.org

The World Trade Organization (WTO), which coordinates trade policy for about 150 countries, offers this Web site to provide key documents and agreements as well as sections that articulate and justify the WTO philosophy of open trade relations among countries.

http://globalexchange.org

Dedicated to a progressive agenda, this Web site includes links to articles and a section on the global economy that emphasizes fair trade, fair loan practices, and greater equality across countries and people.

http://www.cato.org

From the Cato Institute, this site offers evidence, including various online studies and articles, for the benefits of free trade and the costs of protectionism.

www.economywatch.com

Brief characterizations of many national economic systems are provided, including data and graphics, as well as links to other sites.

http://www.weforum.org

The site of the World Economic Forum, an organization designed to allow world leaders to address global issues, contains a substantial amount of information on a variety of international economic issues (e.g., sustainable development, globalization).

http://www.capitalism.org

This libertarian-inspired site describes the core principles of a system of unconstrained, free market capitalism, including a useful glossary, links to articles, a newsletter, banners, and the unique "Capitalism Tour."

http://www.economist.com

The electronic home of *The Economist*, a leading British-based news magazine, provides access to economic data and selected articles examining issues of political economy and world finance.