Pluralist Introductory Economics – no it isn’t too early!

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WHY PLURALISM AT THE INTRODUCTORY LEVEL?

Because something went wrong in 2007/2008.....
Answers to the question posed by THE ECONOMIST:

- Self-fulfilling prophesy of neoclassical economic assumptions in banking sector, leading to TBTF and the crisis (*Alan Greenspan*: model was wrong)
- Efficient Market Hypothesis proven wrong (ignores *systemic risk* and *herd behaviour*)
- Economics students walking away to business schools where more realism is taught (real-world context)
- Relevance of Keynesian policy and QE after the crisis (*US, Europe, China*)
- Recognition of increasing inequality as an economic problem (*Piketty, OECD, UNDP*)
Method

- Country context from across the world
- Real-world examples
- Four theories in every chapter: from broad to narrow
  - social economics
  - institutional economics
  - Post Keynesian economics
  - neoclassical economics
- No judgments of theories
Financial markets

Start with concepts:

- banks and their earnings models: shift over time
- bank balance sheet
- types of financial assets

Example of earning model of spreads:

- car loan to average consumer
- car loan to a consumer in a subprime neighborhood

Table 9.1 Bank balance sheet

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Equity capital</td>
</tr>
<tr>
<td>Loans to customers</td>
<td>Customer deposits</td>
</tr>
<tr>
<td>Loans and deposits to other banks</td>
<td>Borrowing and deposits from other banks</td>
</tr>
<tr>
<td>Repurchase agreements</td>
<td>Repurchase agreements</td>
</tr>
<tr>
<td>Securities</td>
<td>Long-term borrowing</td>
</tr>
<tr>
<td>Derivatives</td>
<td>Derivatives</td>
</tr>
</tbody>
</table>

Equation of bank earnings with high risk premium: charged 100% to the borrower so that banks earn the full spread

\[ Yb - i_{rp} = (i_b^c + i_{rp}) - i_c^b \]
Financial markets: social economics

1. *Segmentation* of financial services =>
statistical discrimination of clients in poor neighborhoods: use of same car loan example with all risks on clients and in derivatives sold

2. *Financialization* (General Motors case: more profit from financial activity than from selling cars)

3. *High liquidity* due to low interest rates =>
sub-prime loans
Financial markets: institutional economics

1. Formal government institutions
   - Basel III regulation
   - Fed policies & deregulation since the 1990s
   - Fed policies & over-regulation since the crisis

2. Private sector self-regulation
   - failure of credit rating agencies
   - failure of Libor system

3. Informal institutions
   - academic legitimization of the EMH
   - banking culture of ‘hubris’

.... low trust in banks
Financial markets: Post Keynesian economics

1. Stock-flow model with the FIRE sector
   - financial fragility
   - securitization
   - financial deepening in global markets
   - unsustainable private debt

2. Herd behavior and bubbles
   - confidence
   - anchors
   - stories
Financial markets: neoclassical economics

1. Efficient Market Hypothesis (EMH)

2. Neoclassical explanations of the crisis:
   - fat tails
   - market failures:
     - moral hazard (TBTF)
     - asymmetric information

EMH: random walk

crisis: high-impact tail event
Economic growth

1. Arguments for growth
   - population growth
   - distributional conflict
   - poverty

2. Measurement and determinants of growth

\[
\frac{Y_{t1} - Y_{t0}}{Y_{t0}} = \Delta Y = g = f(K, L, X)
\]

Economic growth in China

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP growth</th>
<th>Population growth</th>
<th>GDP per capita growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>-27.1</td>
<td>-1.0</td>
<td>-26.4</td>
</tr>
<tr>
<td>1970</td>
<td>19.4</td>
<td>2.7</td>
<td>16.2</td>
</tr>
<tr>
<td>1980</td>
<td>7.8</td>
<td>1.3</td>
<td>6.5</td>
</tr>
<tr>
<td>1990</td>
<td>3.8</td>
<td>1.5</td>
<td>2.3</td>
</tr>
<tr>
<td>2000</td>
<td>8.4</td>
<td>0.8</td>
<td>7.6</td>
</tr>
<tr>
<td>2010</td>
<td>10.4</td>
<td>0.5</td>
<td>9.9</td>
</tr>
</tbody>
</table>
Social economics of growth

1. Quality of growth and values: the role of social cohesion

2. Inclusive growth
   - social conflict reduces social cohesion
   - redistribution may crowd-in productivity

\[ \Delta Y = g = f(K, \text{inequality of } K, L, \text{inequality of } L, X) \]

Redistribution of resources can be efficient

Declining labor share in China: emerging social conflict
Institutional economics of growth

1. State-owned firms beyond public good production
2. State-owned banks and development banks
3. Land-reform and income redistribution
4. Widely accessible and good quality free education at all levels
5. Good quality health care and sanitation
6. Industrial policy including subsidies for selected growth sectors
7. Initially labour-intensive production, later capital/technology catch-up
8. Capital account controls and selective FDI
9. Infant-industry protection
10. Rule of law, even with high corruption

\[ \Delta Y = g = f(K, \text{equality of } K, L, HR, \text{developmental institutions}) \]
Post Keynesian growth theory

1. Demand-led growth
   - example of demand stimulation through consumer demand C
   - extension of example with flat tax for labor class and capitalist class
   - comparison with progressive tax: same tax revenue will result in higher C
   - extension with tax reduction, explanation of the multiplier effect

2. Endogenous growth through $S = I = Y - C$
   - integration of the FIRE sector (I does not get into the real economy, but creates debt)
   - $\Delta Y = g = I / K$
   - China: 10% growth, 40% investment rate, capital-output ratio of 4
Neoclassical growth theory

1. Supply-side as driver of growth
   - aggregate production function
   - technology shocks

2. Neoliberal policies stimulating the supply-side:
   - Lower taxes and lower government expenditures
   - Flexible labour markets
   - Privatization of public companies
   - Flexible exchange rates and open capital markets
   - Deregulation of domestic markets
   - Trade liberalization

New Growth Theory: \[ \Delta Y = f(K, T) + g(L, H) \]
Advantages of the pluralist method

Prevents two pedagogical traps when going beyond neoclassical economics:

1. Trap one: mainly presenting neoclassical economics, then critiquing it in only a few pages
2. Trap two: neoclassical economics bashing: most of the text is not teaching economics but critiquing the dominant theory

Provides real-world context close to student’s own life-worlds and what they read in the news

1. International orientation (Americas, Europe, Asia, Africa)
2. Key issues that they are concerned about (crisis, global warming, poverty, inequality, unemployment, declining growth)
## Challenges & solutions:

1. **Overwhelming** (... though you can always leave one or two theories out ...)

   1. Make schemes of key concepts per theory; in general and per chapter

2. **Students may develop theoretical preferences**

   2. Let them write an essay about a real-world problem from at least two theoretical perspectives

3. **They may lose track of theoretical developments**

   3. Natural way to introduce some history of economic thought

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I teach introductory economics in an MA degree in development studies: this method is much appreciated but indeed perceived as challenging. I consider this an advantage: the world economy needs critically thinking economists ...