

WEBINAR: May 9, 2012

Topic I: The Truth about Deficits, Austerity, and Growth

Topic II: Authoritarian “Statist” Capitalism vs. Western Liberal Capitalism

Topic III: The Hollowing-Out of the American Middle Class

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Topic I: Deficits, Austerity, and Growth

– Today's *New* Debate –

- **All 3 of these terms are interrelated**
- **All 3 are being poorly discussed**

Meaning of “Deficit”

Good Versus Bad Deficits

Country A		Country B	
Government Expenditures	\$ 4 T	Government Expenditures	\$ 4 T
Tax Receipts	\$ 3 T	Tax Receipts	\$ 3 T
<hr/>		<hr/>	
Deficit = \$ 1T		Deficit = \$ 0T	

Paradox

The Moral: It is the composition and quality of total government spending that matters, not the “size of the deficit.”

Rationale for Deficits

– When are they Needed? –

- **Logic of Keynes “Animal Spirits” and Pump Priming**
- **Logic of Arrow-Kurz Relative Rate of Return on Private versus Public Investment**

Animal Spirits

		Low	High
Relative Return - Public vs. Private -	High	Biggest Deficits (Both kinds)	Moderate Good Deficit
	Low	Bad Deficits Needed	Fiscal Surplus

“Austerity” and “Growth”

There is *Macro* versus *Micro* Austerity

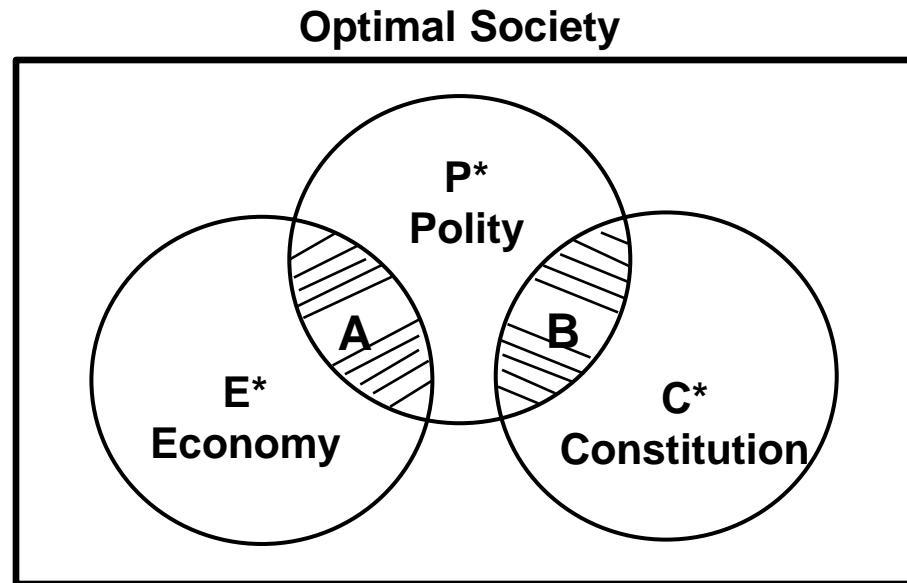
When bond markets and public debt levels get too high, then micro expansion is needed.

This is the case of Europe right now.

Topic II: Authoritarian “Statist” Capitalism vs. Western Liberal Capitalism

Towards an Ideal Social System

– The Oxford Moral Tripos Redux –



E: The Economy (economics)

P: The Polity (politics)

C: The Constitution (ethics)

A: The government regulated portion of E

B: The interference by government into the constitution

The Moral: In an optimal society, the *activities* and the relative *size* of the entities E,P,C,A,B will satisfy performance norms appropriate to each

The two “models” we will compare in terms of this diagram are (1) Western Democratic Capitalism, versus (2) State Capitalism, (e.g., the Chinese model). Communism proper is no longer credible, and thus no longer desired.

Norms for an Ideal Economy E^*

- 1. Efficiency or “Non-Wastefulness”**
- 2. Stability**
- 3. Freedom**
- 4. Privacy**
- 5. Justice (“Fairness”)**
- 6. “Incentive Structure Compatibility” with norms 1-5**

Theorem: True Capitalism alone can satisfy Norms 1-7.

Norms for an Ideal Government P^*

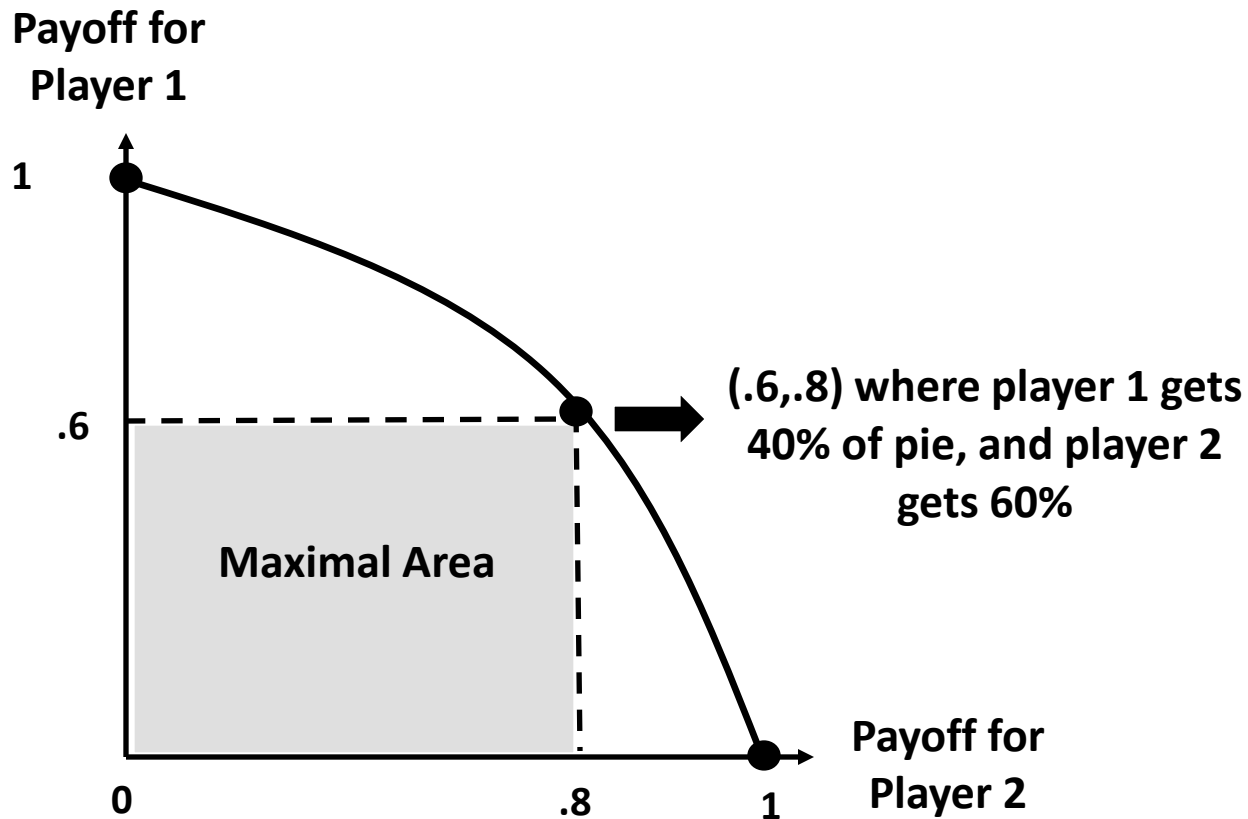
Politics is about eyeball-to-eyeball bargaining between interest groups. We thus want government policies that are:

- 1. Efficient**
- 2. Fair—To Each According to his Contribution**
- 3. Unbiased**

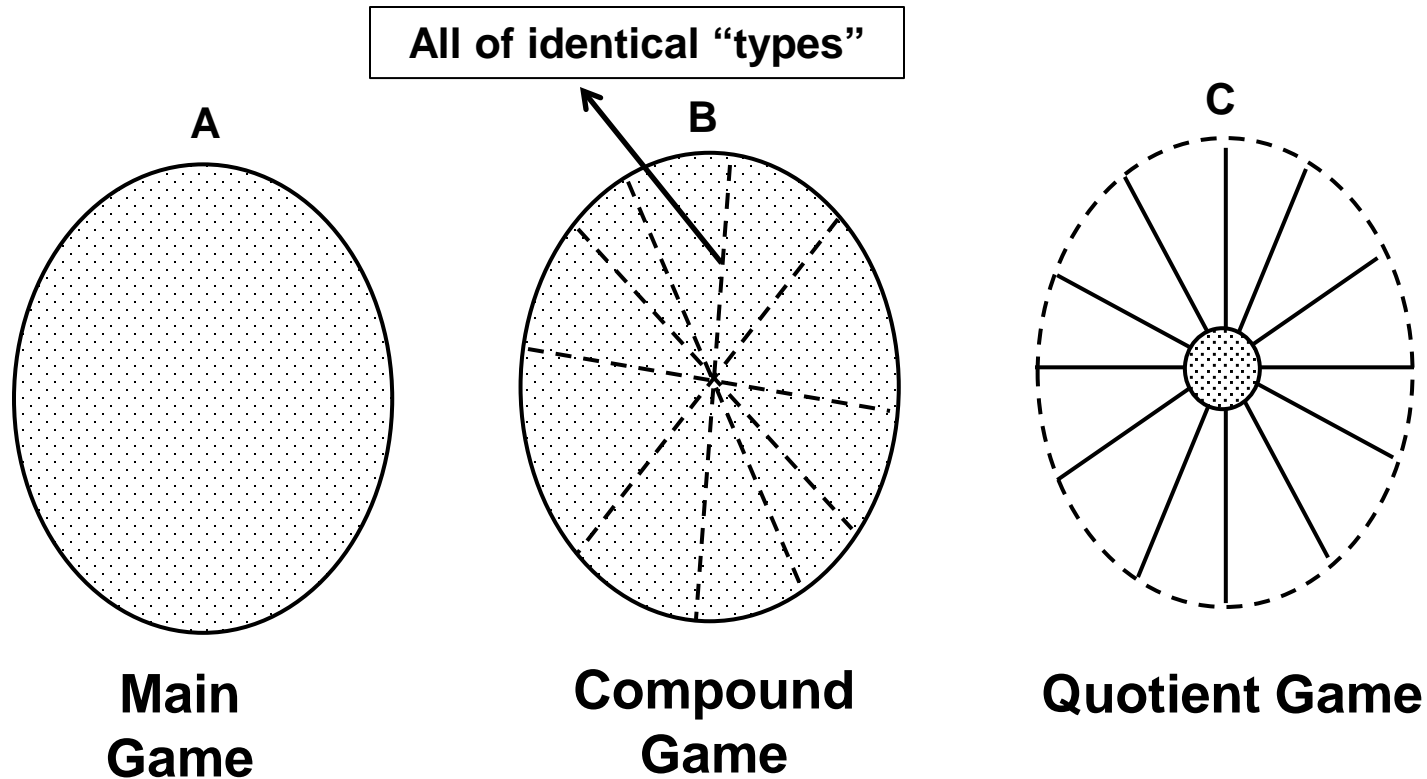
Game Theory now makes it possible to define all three of these Norms. This is new.

Two-Person Bargaining Game

- The Nash Solution -



A Scheme of “Unbiased Representation”



Norms for an Ideal Constitution C*

- Symmetry Conditions -

- 1. Equal Protections and Treatment - Symmetries**
- 2. Distributive Justice—To Each According to his Contribution**

Comparison of the Two Models

- Liberal Democratic Capitalism vs. State Capitalism -

Liberal Capitalism

- The Flaws of this system causing a Decline of the West stem from the polity **P**, not the capitalist economy **E**. Politicians seize on voter insecurities to promise more and more “benefits” no one can pay for. The result: slow growth and myriad sovereign debt crises.
- These flaws along with the crisis in education can and must be solved by constitutional amendments.

The Authoritarian “Statist” Model

- The area **A** becomes too large as government-owned and government-regulated companies seize control of an ever-larger share of the economy. Over time, this slows economic growth a lot.
- The performance of the economy **E** suffers whenever the area **A** becomes too large.
- Statism is the enemy of innovation and “Creative Destruction.” Both are crucial for long-term growth. Can you see a 20-year old innovator taking on 8 huge state-owned companies that are state-regulated and that receive loans from state-owned banks?
- No meaningful Constitution will exist at all. So much for the balance of power needed for civilized society.

What Both Models Share in Common

- Both must be analyzed in terms of their dynamic evolution reflecting their incentive structures
- Both contain the seeds of their own destruction
- Western model can more easily be repaired

Topic III: The Hollowing-Out of the American Middle Class

- **The critical role of productivity growth in Education**

Contact Information



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