

U.S. Macroeconomics

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for the Center for Political Education

Introduction to Political Economy and Radical Economics

Goals

- * Better understand the theories, mechanisms, and related critiques of the U.S. economy,
- * Better articulate a critique of neo-classical economics, both from within the economics framework and outside of it,
- * Better understand the interconnections between different components of the economy and how those components work to maintain the status quo.

Agenda: August 9th, 2007

Series Goals & Guidelines

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Goals of Today's Session

U.S. Macroeconomics

- Unemployment & Inflation
- Accumulation & Investment
- Stock Market
- Bonds & Investments
- The Federal Reserve

Guidelines for Participation

- Step Up, Step Back
- Don't interrupt, please raise your hands
- WAIT (Why am i talking?)--thanks to SOUL for this
- Feel free to ask questions during appropriate times, but please consider whether a question is tangential and can be brought up at a different time or after the class
- Remember our shared interests
- Respect the facilitators
- Respect the presenter and the other participants
- Turn technology to off or to vibrate

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Major Topics for Review

- Neoclassical Economic Theory
- Marxist Economic Theory
- Differences between both theories

Neoclassical Economic Theory

This is the hegemonic and mainstream economic theory but....

Three Major tenets include:

1. The free/unregulated market is the perfect market.
2. This theory believes most markets are perfect. A perfect market is produced when Supply = Demand (ex: chairs)
3. According to this theory, any intervention into markets is negative. Therefore, the best way to solve any issue is to leave it to the market.

Major Camps within Neoclassical Economic Theory

Team A	Team B
Free markets are best in the long run	Free enterprise without government intervention does not generally lead to the best possible outcome.
Market imperfections aren't important	The world is full of market imperfections.
Taxing and redistribution always creates lots of inefficiencies and waste.	Well-designed taxation and redistribution can ameliorate market outcomes.
Human beings are perfectly rational, and always know what's best for themselves.	Human psychology doesn't let them always pick the best outcome for themselves
Politicians always corrupt and self-interested.	Politicians can implement good policy.

Think of these differences as you would the Republican and Democratic parties. There is a difference, but we've got major problems with both!

Major Camps within Neoclassical Economic Theory (2)

Team A	Team B
Republican Party	Democratic Party
University of Chicago	U. of California-Berkeley
“Freshwater Schools”	“Saltwater Schools”
Milton Friedman	Joseph Stiglitz
Robert Barro	Paul Krugman
Friedrich Hayek	JM Keynes
IMF	World Bank

Some Problems of Neoclassical Economic Theory

- It makes no distinction between needs and wants.
- It assumes everything is the outcome of individual choice
- Neither is focused on redistributing wealth or power.
- It assumes monopoly power/market power is rare and temporary, and that the market will break up monopolies.
- It believes most externalities are not really important, and private property rights will fix those that are.
- It assumes markets work perfectly
- It assumes everyone has perfect information (ex: health care)
- Both neglect the role of politics.
 - Team A wants to dismantle government as much as possible.
 - Team B thinks that policy can happen without politics.

Questions?

Marxist Economic Theory

Major Tenets & Concepts of Marxist Economic Theory

- Capitalism tends to crisis
- Capitalism is a “historical” thing AKA “historical materialism”
- Political conflict and change are important components of understanding the economy
- Labor Theory of Value: Capitalists gain surplus value due to their ownership of the means of production.

Questions?

Marxist Economic Theory (2)

Unfortunately, Marxist economics in the U.S. is underdeveloped for several reasons

- Lack Left power and the Right’s assault
- Lack of institutions and resources to advance theory. Mainstream economics gets all the brainpower and intentionally excludes other theories

Too much for this class, it was ambitious to go over this. Still, take a look at the terms and the glossary.

Other Resources: CPE’s Marxism 101 class. “Wage Labor & Capital” by Marx is a good overview.

Some Major Differences between Neoclassical and Marxist Theories

Neoclassical Economic Theory	Marxist Economic Theory
Political power and class conflict play no role in explaining how the economy works	Political power and class conflict are central to explaining how the economy works
Profits are the rewards of risk-taking and savings.	Profit is result of exploitation, AKA the surplus value produced by labor
The tendency of markets is to be stable	The tendency of markets is to be in crisis
Individual choice is and always has been universal	Individual choice is a product of capitalism
Tendency toward competition	Tendency toward monopoly

Q & A Time

Questions about the Review?

How does understanding these differences strengthen the Left?

- Provides us with Ideological ammunition
- Improves our ability to engage in the discourse of economics with “their” language
- Allows us to envision something new
- Others?

Small Group Discussion: Team A & Team B

Break up into small groups

10 Minutes

Discuss:

- Which team is easier to critique?
- Does Team B seem “reasonable?”
- Imagine you are going to be debating a Team B spokesperson on the radio. How would you go about critiquing Team B ideology? Identify your top three message points.

DEBRIEF in large group

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Goals of Today's Class

- Today we will try to cover 1 thing only: Components of the US macroeconomy
- This lets us tie lots of different parts of the economy together.
- By the end, you should be able to understand some components of national or domestic economies ...and understand the readings
- Next week will talk about how these economies interact with each other on the international stage.

What is Unemployment?

Basic Definition: When people who want jobs at the going wage are unable to get them.

In the US, unemployment = people who were looking for a job this month but didn't have one.

What causes unemployment?

How is unemployment measured?

$$\text{Unemployment Rate} = \frac{\text{U.S. unemployment}}{\text{labor force}}$$

Labor force = number of people working + number of people looking for a job.

Problems: This formula underestimates unemployment because it doesn't include people that aren't looking for work (discouraged, in the prison system).

Still, the US unemployment is low by international standards.

Why is the unemployment rate significant?

- One of the main economic indicators
- The unemployment rate is a quantifiable indicator that is used to describe the strength of an economy.
- Governments rely upon it tremendously
- The unemployment rate is also a rough indicator of how well (or not well) poor and working class people are doing

What is Inflation?

Inflation just means prices are going up

- The US has an average inflation rate of ~2%
- What does this mean?
 - If you had a chair that cost \$100 this year
 - Next year it might cost \$102
 - Now imagine a rate of 100,000% like Zimbabwe experienced in 2007. The same \$100 chair would cost \$1,000,000 the following year!

What Causes Inflation?

Possible Causes of Inflation

1. Wage Inflation: The economy is growing and workers are demanding higher wages (normal times)
2. Supply Shock Inflation: The price of certain critical goods is rising. (EX: 1973 Oil Shock)
3. The government increases its printing of money (EX: Zimbabwe).

Inflation also depends on “expectations.”

- I will raise the price of my stuff more if I think the price of everything else is going up.

Progressives/Leftists don't mind the first kind, don't like the second and third

Why is inflation bad?

The Neoclassical Economist Answer:

- HUGE inconvenience
- The tax structure doesn't adjust for inflation
 - eg, my taxes go up when my income goes up, not taking into account that prices have also gone up.
 - 10% tax on 100 dollars is a lot when an ice cream is 10\$!
 - Poor people wind up paying the taxes of rich people
- Locked-in prices in long-term contracts aren't adjusted

What is the relationship between Employment and Inflation?

- Higher employment means wages are higher
- This makes firms raise their prices--inflation!
- Means there is a contradiction between high employment and low inflation.
- Higher Employment → Higher wages → Higher inflation → Higher Prices

Questions?

Why do rich people really hate wage inflation?

- Wage Inflation: The economy is growing and workers are demanding higher wages (normal times)
- Wage Inflation is really bad for capitalists. Why? It reduces the value of future investments in particular savings. (Ex: Cars)
- High inflation, because future prices will be higher, might reduce the amount people save, which means they'll have less to invest.
- However, Good for people in debt. (Ex: Student debt).

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What is accumulation / investment?

Accumulation/Investment is taking resources and putting them into something that will return more in the future.

Accumulation is a Marxist term.

Investment is a Neoclassical term.

How does accumulation/investment occur?

Investors can either keep money in savings or invest it.

The amount of money made depends on the interest rate on savings.

- The Interest Rate is basically the amount charged to borrow the money (EX: buying a house)

But if you change in interest rate on savings, you can affect how much investment occurs

What does it mean to invest?

Most often, capitalists and/or investors don't have enough money to undertake a project (e.g. open a factory), so they need to borrow it.

On the flip side, there are people who have money and looking for ways to make money by lending it out.

In the economy, you can do this in different ways:

- Stocks
- Bonds
- Innumerable, complicated borrowing devices (this is what Wall Street physicists get paid to invent)

What is the relationship between Investment and Employment?

- With new investment comes the need for workers. Starting up factories and stores require people to work there
- Thus, higher investment should lead to higher employment.
- However, sometimes this relationship is pretty weak.

Questions?

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Introduction to the Stock Market

- The stock market is like apple pie
- Celebrated and mystified.
- Supposedly the best capitalist vehicle for allocating resources to investment.

What is a stock or a share?

Share/Stock: Part Ownership of a Company

How do you actually buy a share? What are the mechanics of how the stock market operates?

- Individuals
- Big investors

What is the Stock Market?

- At its core, the stock market is a way for capitalists to raise money from shareholders. In exchange, the capitalists must answer to the shareholders.
- Think about this for thousands of companies.
- Stocks give you a say in running the company (Ex: Buying shares in Microsoft)
- The Stock Market facilitates accumulation: The whole thing is about making money so you can in turn take that money and reinvest, and then again make some more money.

What does a share/stock give an investor?

1. Dividends: A chunk of future profits.
2. Capital Gains: The amount you can get if you sell the stock at a higher price than you bought it for.
3. A vote: the ability to have some say over the management of the company.

There are two investing styles:

Short-term: Capital Gains due to rapid price changes.

Long-term: Dividends accumulating because the company is profitable.

Stock Market: Some History

- Something vaguely like this existed in Medieval Italy.
- Imperial companies (e.g. British East India company) floated shares in the 1600s.
- First exchange is Paris Bourse: 1727
- Modern stock market: London 1802
- NYSE: founded 1792 but tiny.
- US stock markets got big around when the US got big corporations; late 19th century

How does the Stock Market work?

When you buy a stock, how does the company turn it into investment (hire more people, buy more machines)?

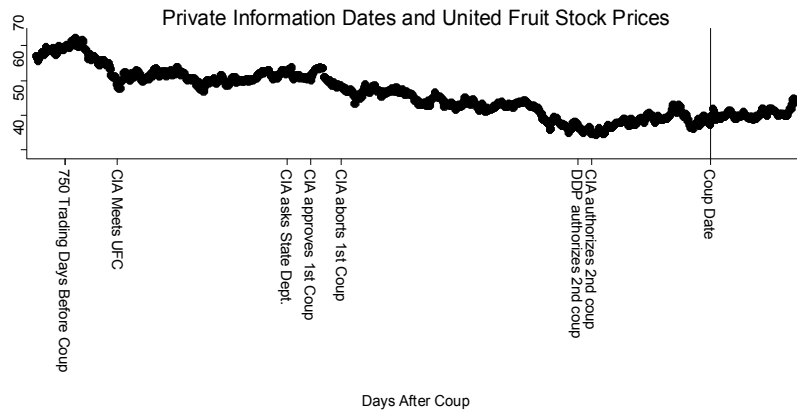
- 1) Initial Public Offering: When a company needs a big shot of initial cash, it offers a pile of stock to get start-up money
- 2) Borrowing: Having a high stock price means that the market thinks you will have high profits in the future, so more people are willing to lend to you
- 3) Stock splits: (rarer) you can issue more stock, and sell it at the going price to take in some cash to invest. Problem: this lowers the price of the share, and diminishes the value of the stock held previously.

Arguments the Right uses to defend the Stock Market

- Democratic
- Stock market allocates funds to the best uses. Creates incentives to find out where inefficient companies are and either liquidate or reform them.
- Stock price reveals profitable information that is held by a few individuals.
 - I.E. if I know something about a stock that no-one else does, I'll be able to make money on it. (See next graph)

Equal Access to Information?

CIA Guatemala coup plans and United Fruit Stock Prices



What is a Left critique of the Stock Market?

- Creates inequality because it means that if a company does astoundingly well, stockholders of that company can make a lot of money.
- Most stock trading has nothing to do with productive investment, just speculation.
- Most of the real action is insider trading.
- Lots of asymmetric information!!
- Stock markets are stupidly unpredictable and volatile. Exhibit lots of herd behavior.

Digression: What is herd behavior?

Herd Behavior explains financial crisis

- Herd behavior/Beauty Contests/Fundamental uncertainty-
- All capture the idea that financial markets are volatile and exhibit vast collective stupidity.
- A few people get nervous, pull their money out of an asset, then everyone else gets nervous, and there's a huge stampede out.
- Similarly, can get bubbles.
- This is true about bonds, currencies, housing, most especially the stock market.
- Fundamental to the left critique of finance.

Class analysis of the stock market

- Stock market is a device to unite the capitalist class.
 - Lets you disperse ownership of the means of production to all members of the class;
 - All capitalists start looking like financial capitalists. Hold portfolios instead of individual companies.
 - Gives the state a single number to look at to get a rough sense of the mood of capitalists.
 - Nothing like this for the working class!
- Questions?

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What are Bonds?

Remember, Bonds are another way to raise money but it is more like a loan (instead of stocks)

A Bond is essentially a loan with a fixed interest rate.

Useful Terms

- Bond holder = lender
- Bond issuer = lendee
- Maturity-when the loan will be paid back

In this class, we are only talking about government bonds because they have a much greater impact on the economy.

What is the Bond Market?

Buying and selling bonds before they mature is the bond market

Q: What determines the price of a bond?

A: How many other bonds are out there that give a higher interest rate. If there are lots of bonds with a higher interest rate, then bonds with lower interest rates will have a low price.

What do Bond Prices and Interest rates have to do with each other?

What is an interest rate?

It's the amount you charge a lendee to borrow your money. Usually, a percentage of the amount you borrow.

- 2% Interest Rate on 1-year \$100 loan would give you a return of \$2.

When there are new bonds issued at higher interest rates, the price of existing bonds (with lower interest rates) falls because nobody wants them.

What is a Government Bond?

Just a loan to the government

- Short Term bonds are 3-month loans
- Long Term bonds are 20-30 year loans
- Government generally covers its budget deficit by issuing long-term bonds

Who makes these loans?

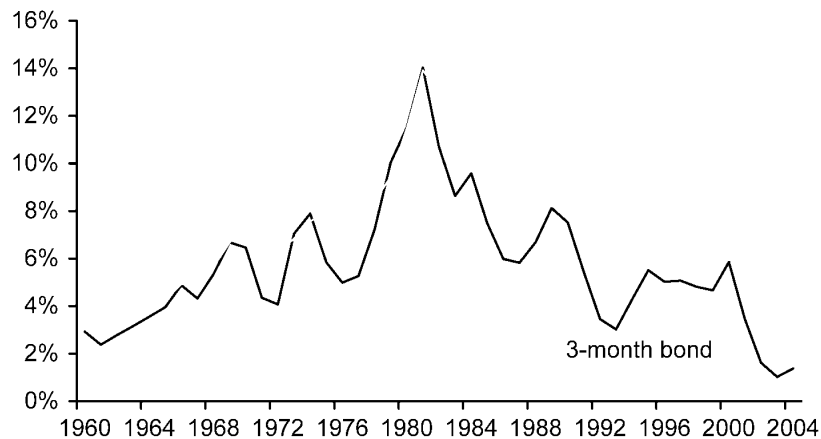
- Anyone (Big institutional, individuals, other governments)

All bonds we'll talk about for the rest of this class are government bonds

The connection?

- The interest rates of short-term and long-term bonds tend to move together.
- This is because bond traders move to the bonds with the highest interest rate.
- So if the interest rate on short-term bonds rises, everyone will want them, and so the long-term bond issuers will have to raise their interest rates too.
- We can talk about “The” interest rate as the interest rate on short term bonds.

Long and short bond interest rates



How does the Bond Market interact with the Stock Market and investments?

- Investors can either hold money in bonds or stocks.
- If the interest rate (on bonds) is low, investors will put more of their money into the stock market, and this should raise investment.
- This is how low interest rates stimulate investment.

Questions?

Bond Market

- So, what determines the interest rate?
 - How much the US wants to borrow?
 - If private investors want to lend to US, don't need to pay them high interest.
 - If few private investors want to lend to US, need to pay high interest.
- Is there a market to lend to the US?
 - Yes! Seen as the ultra-safe investment.
 - But, taxes eventually need to be raised to cover the interest payments on the debt.

Who is in the bond market?

- Back in the 1990s, the private sector “bond vigilantes”.
- Big institutional investors, as well as some just rich people.
 - Carville: "I used to think if there was reincarnation, I wanted to come back as the president or the Pope or a .400 baseball hitter, but now I want to come back as the bond market. You can intimidate everybody,"
- After the emerging markets crises: China, East Asia, Brazil central banks are the big players. Next week!
- Generally, the left analysis has focused on the critique of private bond traders

Political Power of the Private Bond Market

- When the Clinton administration tried to spend too much, the bond market would start dumping US bonds, raising the rate of interest the government had to pay on new loans
- This made the administration decide to run a budget surplus, so that they could pay off the bond holders and lower the dependence of the government on the market.
- Funny, the bond market doesn't do this to Bush.

Questions?

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What is the Federal Reserve?

- Founded in DC in 1913 to regulate national banks and govern money supply.
- Supposed to be independent of political party.
- Chairman appointed for 14 year terms.
- Key body is the Federal Open Market Committee
- Meets every 6 weeks to decide what the interest rate should be.
- Decisions by FOMC are made by consensus, though Chairman mostly gets his/her way.

What does the Fed claim to do?

Adjusts the short-term interest rate by buying and selling short-term government bonds.

“Raising the interest rate”

Sell bonds → lower investment → lower employment
→ lower wages → lower inflation

“Lowering the interest rate”

Buy bonds → increases investment → higher employment → increases wages → higher inflation

Fed tries to balance inflation and unemployment using the interest rate.

Class War and the Fed

- Fed pretty much run by the capitalist class.
- This is because, under capitalism, the expectations of capitalists are what matter.
- So the Fed bends over backwards to pander to business, so that it has credibility that it will not jerk them around when it needs to alter their behavior.
- Means Fed keeps inflation low, regardless of employment levels.
- Favors capital over workers

Putting it all together

- Government wants to stimulate the economy/create jobs
- Can either do it itself or lower the interest rate on bonds in order to get investors to invest more. Latter is faster.
- If investment goes up, more jobs, wages go up, prices go up and inflation rises
- Inflation hurts capitalists/investors more than workers/debtors.

Questions?

Example: This week's NYTimes reading

- The takeaway from this week's New York Times reading:
- The economy was growing and investment was increasing,
- But wages aren't growing
- So there is no threat of inflation,
- Therefore the Fed does not have to increase the interest rate.

Example: The Volcker Disinflation

- 1970s high inflation (like 9% in 1979)
- Paul Volcker new Federal Reserve chair
- Sharply raises interest rates, employment falls a lot.
- But inflation does fall to 3% by 1986.
- A Consequence: Unions lose a lot of power. Rough times for the left and the working class.

Example: The Roaring 1990s

- The 1990s were "the fabulous decade"
- High employment, high wages, not much inflation.
- Early 1990s, Greenspan makes the call that the economy can grow (employment increase) much more than previously thought without raising inflation.
- He was right. And ppl think he was a genius.
- Otherwise, the Fed may have increased interest rates too early, choking off the boom.

Next week: Connecting the Domestic to the International

- Two things affect interest rates: bond market and Federal reserve.
- Bond Market Behavior:
 - Private traders: volatile and herd-like.
 - Foreign central banks: Who knows?
 - A large chunk of US bonds are held by non-US entities.
 - Why do non-US ppl/governments do this? Need to look at the international dimensions...