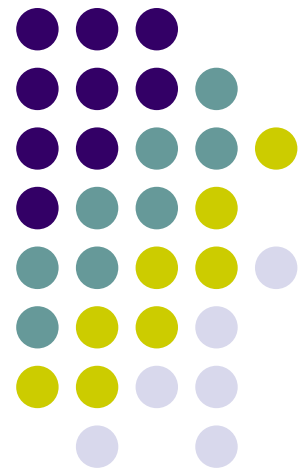
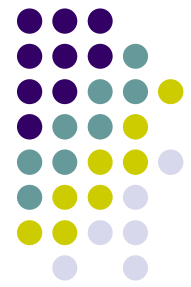


Introduction to Economics of Development

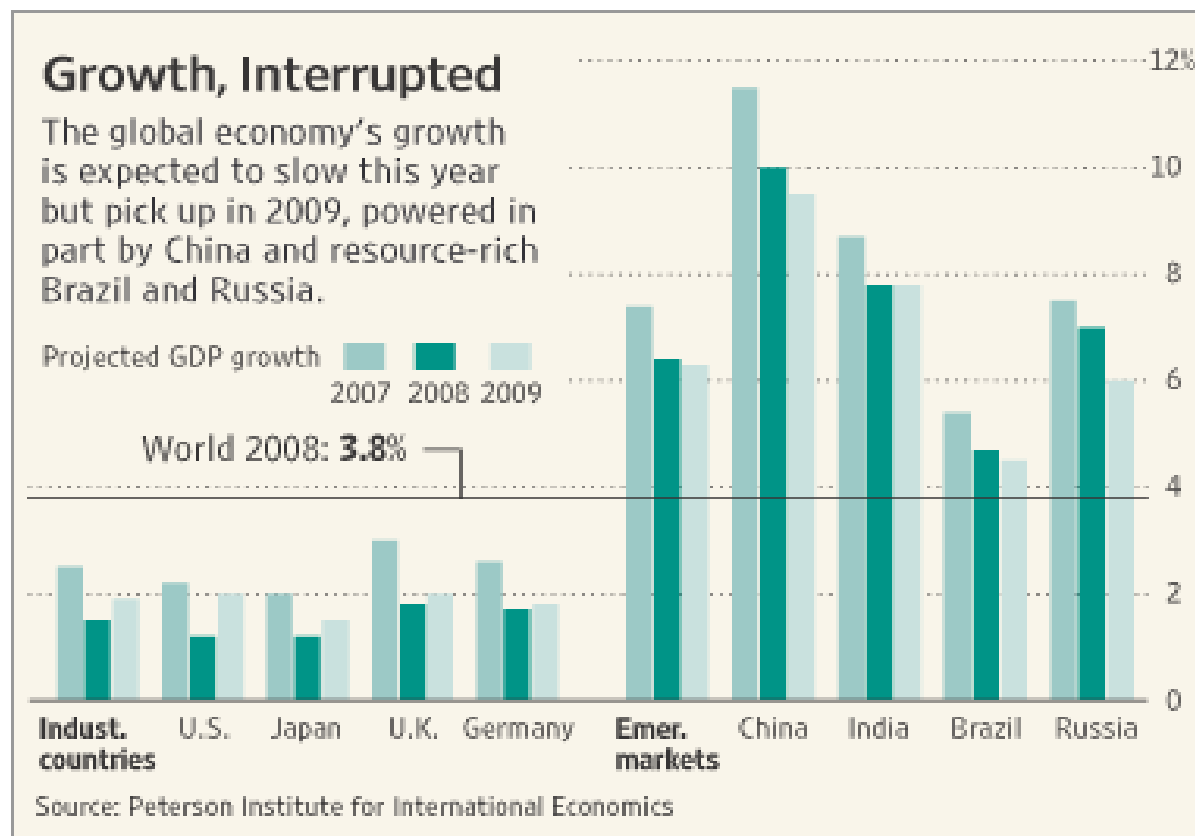
Government, Markets
& Economic Development

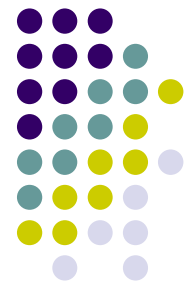




What's happening 4/8/08

An update on global growth projection





What's happening 4/8/08

Greenspan: It's not my fault.

Greenspan Defends His Legacy



Associated Press

Alan Greenspan was lionized for the economy's performance for much of his 18 years as chairman of the Fed, but now, he notes, he's being second-guessed for it. At 82, he wants to set the record straight before the ink dries on the first draft of the current financial crisis' history. 8:57 a.m.



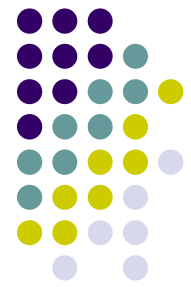
Governments vs. Markets: battle of ideas

- Motivational questions:
 - On governments:
 - What are the proper roles of government in an economy or society?
 - Are governments superior to the governed, i.e., the people?
 - Do you think governments are all made of saints or do-gooders, having perfect foresights, or they are made of individuals who suffer the same weaknesses as common people?
 - Do human beings have the natural urge to turn to government for help in a time of crisis?
 - Do you think expanding government power will help or hurt individual freedoms?



Governments vs. Markets: battle of ideas

- Motivational questions:
 - On markets:
 - What are those areas that markets could fail? Be it market failures or market imperfections.
 - In modern history, do you observe any country or regime that prospered but not primarily relying on market system to organize their economic activities?
 - What is the relationship between market-based capitalism and human freedom?



What's happening 4/15/08

Harry Potter Case Gets Emotional For Man Facing Off Against Rowling

Associated Press
April 15, 2008 3:00 p.m.

NEW YORK -- A Harry Potter fan who sought to publish an encyclopedic guide to the wildly popular fantasy novels broke down and cried on the witness stand Tuesday as he faced off in court against his idol J.K. Rowling.

The British author sued Steven Vander Ark's publisher RDR Books last year, claiming that their "Harry Potter Lexicon" -- based on Vander Ark's Web site -- infringed on her copyright.

Mr. Vander Ark wiped away tears when he was asked to reflect on what the case has done to his relationship with the community of Harry Potter fans.



Adam Smith on Government vs. Private

- **"Great nations are never impoverished by private**, though they sometimes are by public prodigality and misconduct.... Those unproductive hands ... may consume so great a share of their whole revenue ... that all the frugality and good conduct of individuals may not be able to compensate the waste and degradation of produce occasioned by this violent and forced encroachment."
- **"The uniform, constant and uninterrupted effort of every man to better his condition ... is frequently powerful enough to maintain the natural progress of things toward improvement**, in spite both of the extravagance of government, and of the greatest errors of administration ... it frequently restores health and vigor to the constitution, in spite, not only of the disease, but of the absurd prescriptions of the doctor ... it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often encumbers its operations."



Adam Smith



Adam Smith on Limited Roles of Government

- “The **first** duty of the sovereign, [is] that of protecting the society from the violence and invasion of other independent societies...”
- “The **second** duty of the sovereign, [is] that of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it...”
- “The **third** and last duty of the sovereign or commonwealth is that of erecting and maintaining those public institutions and those public works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature that the profit could never repay the expense to any individual or small number of individuals, and which it therefore cannot be expected that any individual or small number of individuals should erect or maintain.”



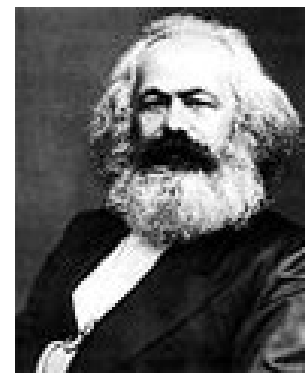
Thomas Jefferson, “Declaration of Independence”

We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness. — That to secure these rights, Governments are instituted among Men, deriving their just powers from the consent of the governed, — That whenever any Form of Government becomes destructive of these ends, it is the Right of the People to alter or to abolish it, and to institute new Government, laying its foundation on such principles and organizing its powers in such form, as to them shall seem most likely to effect their Safety and Happiness.



Marx's economic theory of labor value

- Marx thinks labor or worker is the ultimate source of value creation in a society.
- Capitalists hire workers for the rights to use their labor, but workers produce much more value than wage. The extra value, which Marx called surplus value of labor, becomes capitalists' profits and in this sense, workers are exploited.

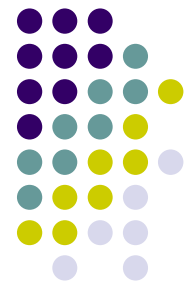


Angry Karl Marx
(1818-1883)



Marx's political theory

- In 19th century Europe, Marx witnessed deteriorating living/working conditions of workers. Wage was kept at minimum level barely for workers to survive. Marx thinks working class in the world should unite in their long struggle against capitalist class. The goal is to overthrow the governments controlled by wealthy capitalists through revolution and win back power and rights and give them to the people.
- Marx also looked at progress of human society with a historical destiny. He thinks capitalism, just like slave society, and feudalism, is just one stage of human development. After capitalism, a higher and more advanced system should emerge, that's socialism first, then followed by communism.
- Marx thinks capitalism can't overcome its inevitable demise. After revolution, workers, through their pioneers, Communist Party, establish proletarian (workers') dictatorship, and lead people first through socialism. Then socialism eventually leads to communism, where distribution is according to *need*, the ultimate Utopia.



Why Marx got it all wrong?

- Labor is not the sole creator of value:
 - Readers of Marx's theory often find his theory is very hard to dispute.
 - Karl Popper: any good theory must be contestable.
 - Marx's theory has perfect logic reasoning.
 - But his assumption was wrong and this led to wrong prediction!
- The role of capital, natural resources, management skills, ideas and entrepreneurial spirit.
- With skilled labor and investment in human capital, we actually observed a gradual rising of labor income over the years. Workers in capitalist society are much better off than workers in former socialist economies.
- Most importantly, capitalist society all prospered, and people see no end of it. On the other hand, social experiments in the 20th century following Marx's theory all failed miserably.
- These socialist experiments, all started with good intentions, ended up with ubiquitous poorer and less free people/society.

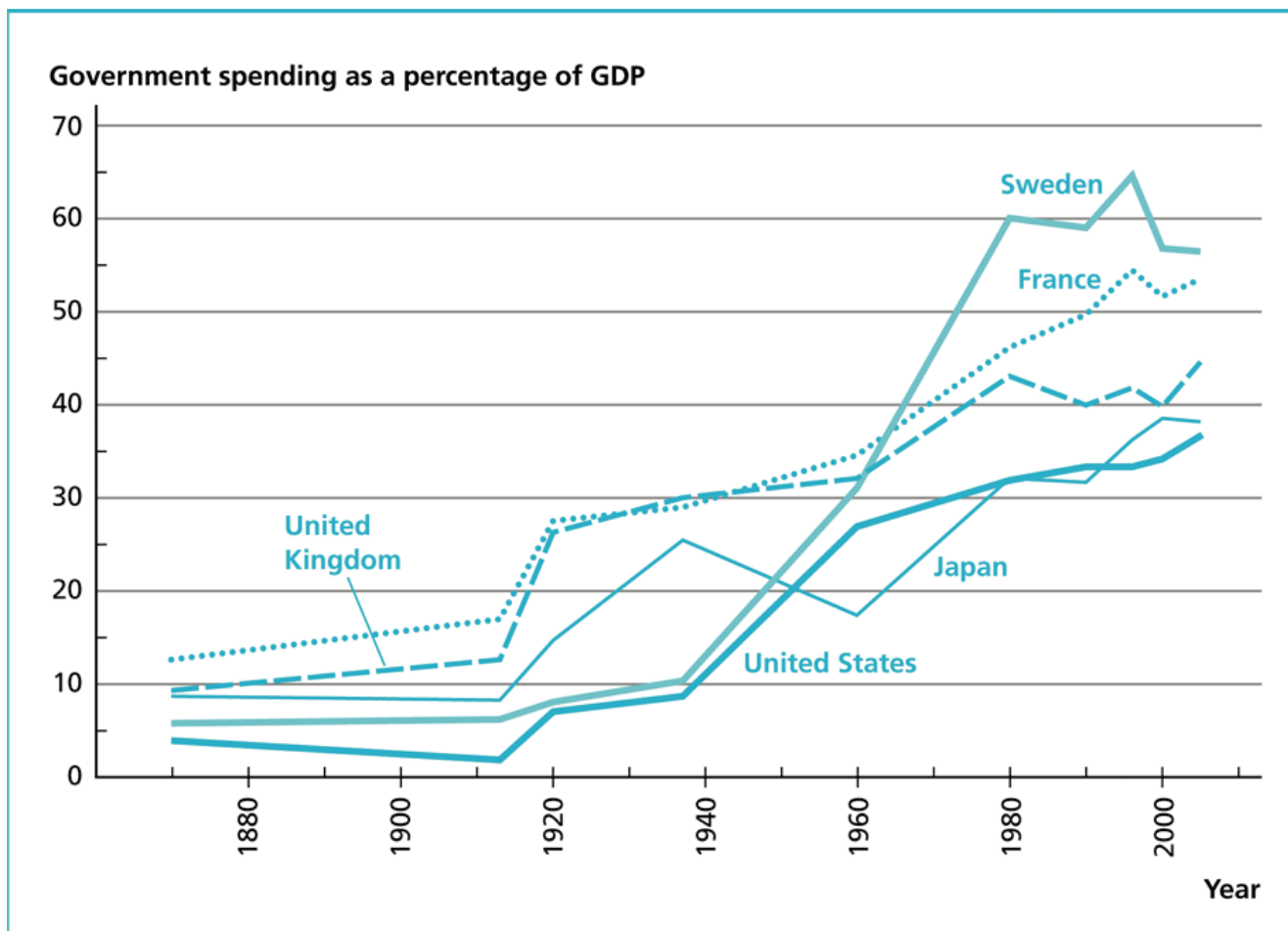


Battle of ideas in Cambridge, Mass.

- [The Crimson](#) reports:
 - When Harvard's future dean of admissions and financial aid was applying to the College in 1962, the first two teachers he asked for letters of recommendation refused.
 - "They wouldn't write for Harvard because they thought it was a bunch of Communists, a bunch of atheists, a bunch of rich snobs, and if you went there you'd flunk out and you'd lose your soul," said William R. Fitzsimmons '67.

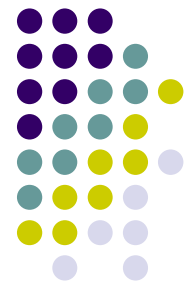


Growth of Government Spending, 1870–2005

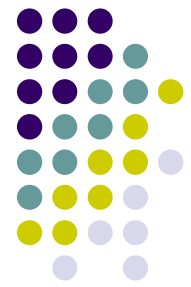


Source: "The Future of the State," *The Economist*, September 20, 1997, OECD.

Tax as a % of GDP in the world



#	Country	Tax in % of GDP (2005)
1	Sweden	51.3
2	Denmark	50.3
3	Belgium	45.5
4	Norway	44.3
5	France	44.0
6	Finland	43.9
7	Iceland	42.4
8	Austria	42.0
9	Italy	40.6
10	Slovenia	40.5
11	Germany	38.8
12	Hungary	38.5
13-14	Luxembourg	38.2
13-14	The Netherlands	38.2
15	United Kingdom	37.0
16	New Zealand	36.6
17	Czech Republic	36.3
18	Spain	35.6
19	Bulgaria	35.9
20	Cyprus	35.6
21-22	Malta	35.3
21-22	Portugal	35.3
23	Poland	34.2
24	Canada	33.5
25	Turkey	32.3
26	Estonia	30.9
27-28	Australia	30.9 ^[2]
27-28	Ireland	30.8
29	Switzerland	30.0
30	Latvia	29.4
31	Slovakia	29.3
32	Lithuania	28.9
33	Romania	27.3
34	United States	26.8
35	South Korea	25.5 ^[2]
36	Mexico	19.9 ^[2]



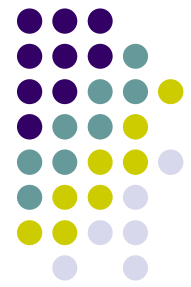
Year 2007 income brackets and tax rates

Marginal Tax Rate	Single	Married Filing Jointly or Qualified Widow(er)	Married Filing Separately	Head of Household
10%	\$0 – \$7,825	\$0 – \$15,650	\$0 – \$7,825	\$0 – \$11,200
15%	\$7,826 – \$31,850	\$15,651 – \$63,700	\$7,826 – \$31,850	\$11,201 – \$42,650
25%	\$31,851 – \$77,100	\$63,701 – \$128,500	\$31,851 – \$64,250	\$42,651 – \$110,100
28%	\$77,101 – \$160,850	\$128,501 – \$195,850	\$64,251 – \$97,925	\$110,101 – \$178,350
33%	\$160,851 – \$349,700	\$195,851 – \$349,700	\$97,926 – \$174,850	\$178,351 – \$349,700
35%	\$349,701+	\$349,701+	\$174,851+	\$349,701+



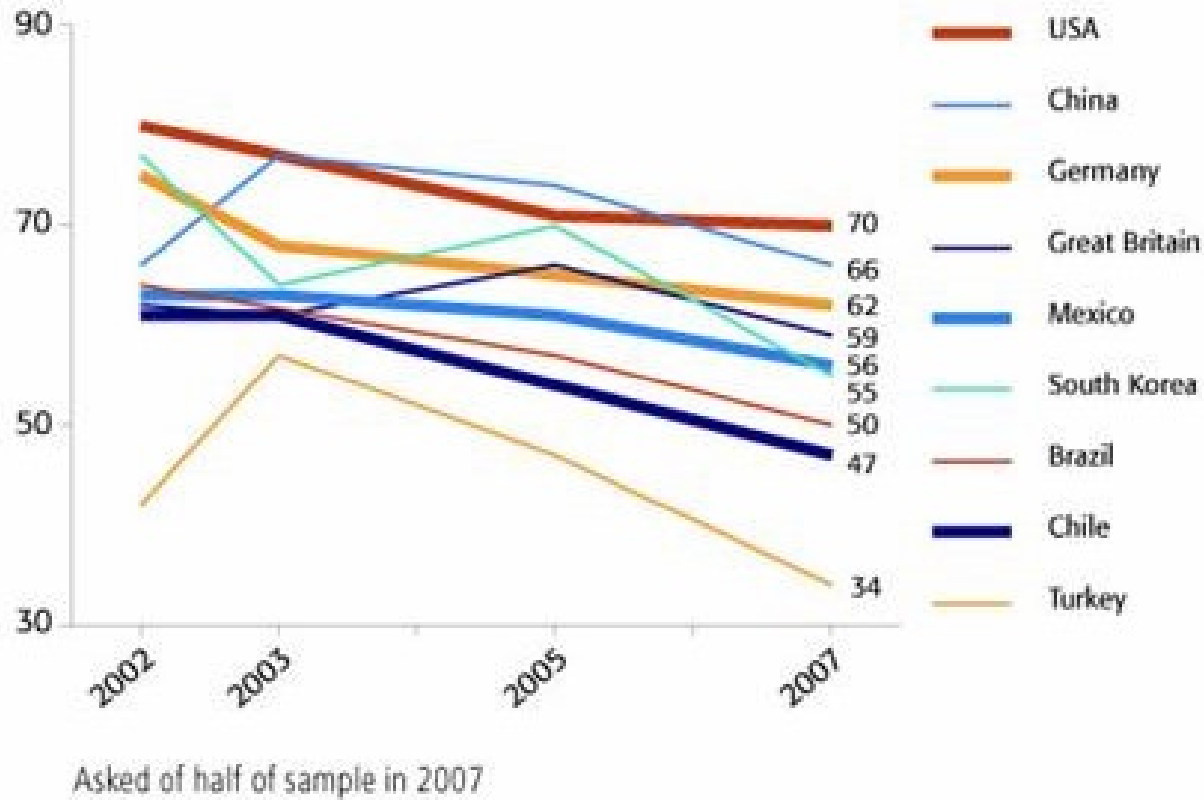
Milton Friedman on Government Spending: Distorted Incentives

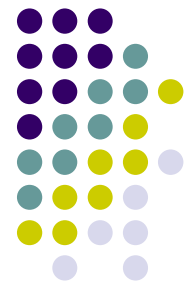
- There are four ways in which you can spend money:
 - **You can spend your own money on yourself.** When you do that, you really watch out what you're doing, and you try to get the most for your money.
 - Then **you can spend your own money on somebody else.** For example, I buy a birthday present for someone. Well, then *I'm not so careful about the content of the present, but I'm very careful about the cost.*
 - Then, **I can spend somebody else's money on myself.** And if I spend somebody else's money on myself, then I'm sure going to have a good lunch!
 - **Finally, I can spend somebody else's money on somebody else.** And if I spend somebody else's money on somebody else, I'm not concerned about **how much it is**, and I'm not concerned **about what I get**. And that's government. And that's close to **40%** of our national income."



Perceptions around the world (1)

Free Market Economy Is Best Model for World
"Strongly" and "Somewhat Agree," Decreases: 2002–2007

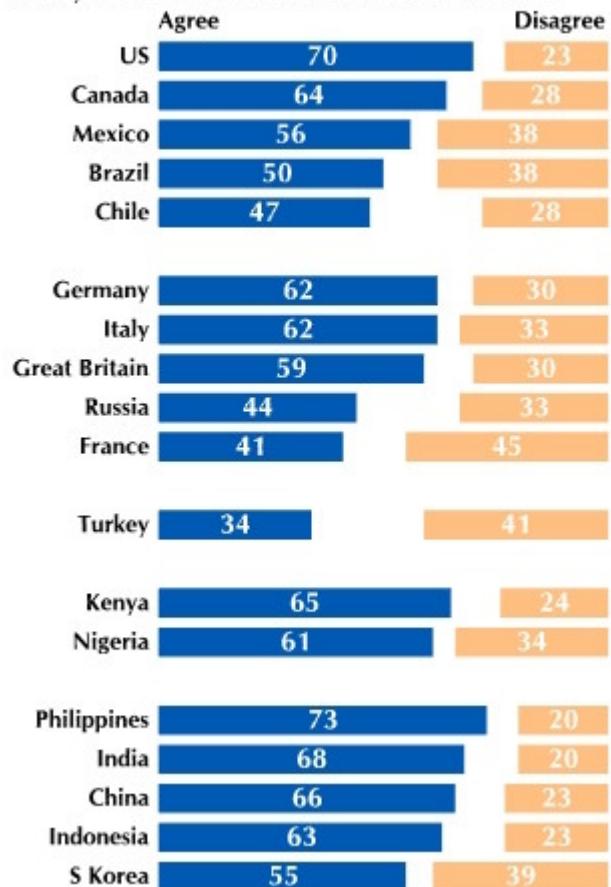




Perceptions around the world (2)

Free Market System

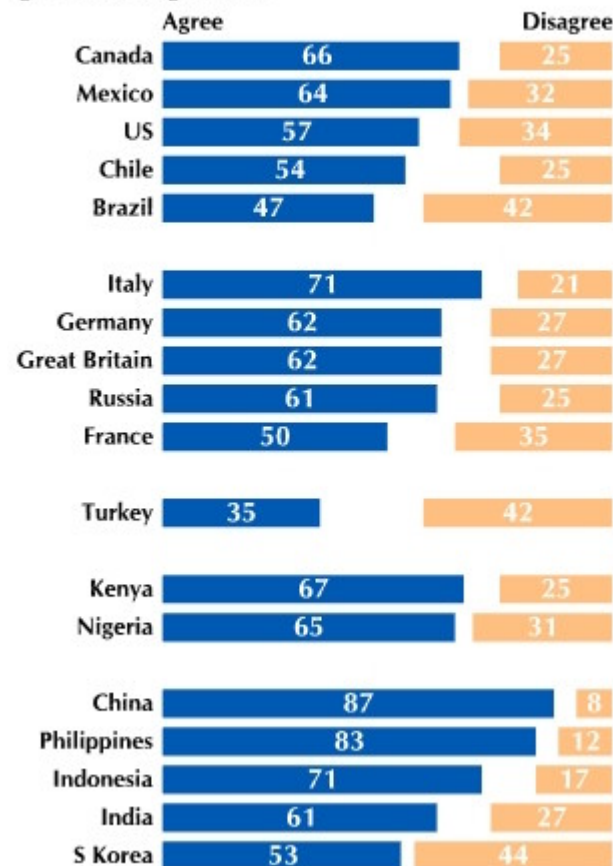
The free enterprise system and free market economy is the best system on which to base the future of the world.



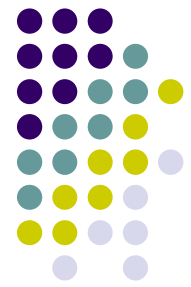
GlobeScan, 8/07

Strong Government Regulation

The free enterprise system and free market economy work best in society's interest when accompanied by strong government regulations.



GlobeScan, 8/07



Washington Consensus

- John Williamson (1990) formulated the notion of the “Washington Consensus.”

<u>Original Washington Consensus:</u>	“Augmented” Washington Consensus: ... the previous 10 items, plus:
<ol style="list-style-type: none"> 1. Fiscal discipline 2. Reorientation of public expenditures 3. Tax reform 4. Interest rate liberalization 5. Unified and competitive exchange rates 6. Trade liberalization 7. Openness to DFI 8. Privatization 9. Deregulation 10. Secure Property Rights 	<ol style="list-style-type: none"> 11. Corporate governance 12. Anti-corruption 13. Flexible labor markets 14. Adherence to WTO disciplines 15. Adherence to international financial codes and standards 16. “Prudent” capital-account opening 17. Non-intermediate exchange rate regimes 18. Independent central banks/inflation targeting 19. Social safety nets 20. Targeted poverty reduction



Some universal prescriptions

- Larry Summers (2003) summarizes the recent growth evidence:

“[The] rate at which countries grow is substantially determined by three things: *their ability to integrate with the global economy* through trade and investment; *and their ability to put in place an institutional their capacity to maintain sustainable government finances and sound money environment in which contracts can be enforced and property rights can be established.* I would challenge anyone to identify a country that has done all three of these things and has not grown at a substantial rate.”