Chapter Fourteen Short Answer (Answers Below)

1. Explain the strengths and weaknesses of economic modelling.
2. Account for the factors that contributed to the reform of capitalism in the twentieth century.
3. Explain the core elements of Keynesian theory.
4. Explain the primary features of the welfare state.
5. Explain the relationship between expanding public debt and challenges to the welfare state.

Answers

1. The strength of economic modelling is its predictive capacity. Models of economic behaviour allow us to understand, and ideally predict, market activity. This capacity can be used to generate private profit, but it can also be used for the public good, for example, by anticipating and either warding off or mitigating economic crises. The weakness of economic modelling is that it can never be accurate; even the core assumptions we make about the market, including voluntary participation, the availability of information, and freedom of choice, are noticeably flawed. As such, it becomes difficult to argue that models of the economy actually provide real insight. The fact of externalities, hidden benefits and costs generated by market activity, means that no model can accurately mimic or predict market activity.
2. A number of factors created the political conditions prompting reform of capitalism. The political threat of socialism, with its potential to radicalize the population, made political leaders more open to compromise. The active efforts of social reformers pushing specific legislative agendas gave focus to reform efforts. The rise of trade unions provided a collective basis by which workers could exert political influence and demands. The expansion of the vote compounded this, giving a broad population the ability to participate in the electoral process. Taken together, this created a political context in which the interests of the broad population had to be taken into account, and the worst excesses of capitalism could be addressed and reformed.
3. Keynes argues that the slumps that were characteristic of the business cycle were caused by the interaction of overproduction and insufficient demand. Consequently, he advocated a system of demand management to counter the worst effects of the cycle. In slow periods, the government would act to stimulate consumer demand, while in boom periods, it would act to limit it. This was to be achieved by overspending in periods of economic decline and over-taxation in periods of growth. The net effect would be to smooth out the peaks and valleys of the business cycle.
4. The welfare state is primarily active and redistributive; it deliberately manages the economy in order to redistribute wealth. Traditionally, core goals included full employment, the provision of universal social programs, and the creation of a social safety net for those in need. The creation of the welfare state likely involved a negotiation between business, labour, and government in the post-World War II period, although the precise form and scale of the negotiated consensus varied considerably from state to state. In practice, the welfare state tended not to emerge as a coherent project, but rather as a loose collection of policies and programs accumulated over time. The primary tool of the welfare state is redistributive government spending, either through direct transfers or through indirect transfers via public social programs. The recent resurgence of classic economic liberalism has challenged the existence of the welfare state.
5. Expanding public debt puts pressure on a government’s ability to spend. Interest payments take up an increasing portion of total government spending, which limits resources available for other expenditures. In the late 1970s and 1980s, facing expanding debt and the political consequences of raising taxes, governments opted instead to reduce spending. This involved cutting expenditures on social transfers and programs, the cornerstone of the welfare state.