CHAPTER 2

Economics

Interests, or the first 'I' of the 3-Is, encompasses a wide variety of domains, ranging from what sustains a person (food, energy, clothes, shelter) to what makes life livable (medical care, body care, education) and enjoyable (sports, arts, leisure). Providing for these interests is done by managing the production and distribution of resources and goods. The management of the production, distribution and consumption of such goods is called economy. These activities have always been part of the lives of humankind. People have structured their economic activities on individual, communal, national and global levels.

Economy refers to the way in which people provide for their needs. **Economics** is the name of the academic discipline that studies how and why people make decisions about production and distribution of goods and services.

Economic systems

An economy is a mechanism that balances the needs of people with their resources (land, ores, oil, water – see chapter 'Resources and Climate'), their 'inventories' (raw materials, foodstuffs, product parts) and 'capital' (everything needed for production, like human labor and ingenuity, tools, machines, factories, transport). Important in this equation are the people themselves: they determine their needs and what must be produced to cater to those needs, just as their qualities and abilities will determine if and how they manage to produce what needs to be produced. These needs can be stimulated by technology (think of inventions like agriculture, machines, mobile phones), but also by *ideas* (such as the prohibition or the encouragement of certain foods or practices like veganism, religious dietary laws, religious bans on electricity or vaccination).

The ideal situation would be the perfect balance of needs and resources so that people can live a good life. To reach that balance, people developed various types of economies. The early forms were **pastoral**, **trade-based** and **agriculture-based** economies to be joined later by the **industry-based** economy. How these economies were implemented and how they evolved, differed depending on time and place. While pastoral economies gradually disappeared with time, the other three economic systems became increasingly global and very few countries today have a national economy that is fully self-sustainable ('autarkic').

With the emergence of states and industrialized forms of production, two other types of economy developed. One is the **planned economy** in which governments regulate production and therefore consumption. In this system, people only participate in the production process in positions that are allocated to them, and their consumption is usually rationed. The other type is known as the **market economy**, in which the government plays a minimal role, and the production and consumption of goods are left to the needs and initiatives of the people. Of course, these are two archetypes of economic systems, and most of today's economies are a mixture of the two. But these are not economic systems of their own accord: they are put in place by people or, more commonly, their governments. The manner in which economies are shaped stem from *ideas* that people have on how best to manage them.

Ideas about economy

Economists and ideologues have come up with various ideas on how an economy could be organized to best serve the interests of society. In the nineteenth century, two models emerged that still apply today, albeit with many adaptations. Key to these models are the notion of private ownership and the role of the state.

The first model is **capitalism**. It is based on the notion of private ownership, meaning that the capital (labor, tools, money, etc.) needed for production is privately owned and its owners are free to decide what to do with that capital. The state ideally plays no role in the regulation of the market or in labor rights, nor in environmental, ethical or public health issues. That's why capitalism is usually found in market-based economies. In such economies, however, different choices can be made regarding the financial involvement of the state in matters of education, housing, healthcare and infrastructure. While these choices are matters of political debate, all states nowadays agree that the organization and costs for the protection of the country (judiciary, army and police) are the exclusive domain of the state.

The second model is **communism**. Communism was a response to some of the excesses of the capitalist system whereby people without capital (who represented the largest part of the population) depended on those with capital. This disparity led to poverty among the greater working population and excessive wealth among the few who owned the capital. That is why the communist model denounced private ownership and stipulated that all capital should be jointly owned by those who did the work (the working class). The entire population of a country should become a single working class, and the state, as the representative of the population, must administer and manage the joint ownership of capital. While in name the people own all the capital, the state has a central role in regulating anything that has to do with the economy. One of the downsides of such a system of planned economy was that various communist states made political or economic miscalculations in regulating the production of goods. For instance, the Soviet Union emphasized the development of heavy industry in the 1930s which resulted in famine because there were not enough resources left for agriculture.

Nowadays, most states use hybrid forms of these two systems, whereby the main question is always how much (or how little) power the state should hold in regulating the economy. Choices made in this respect are always driven by *interests* and *ideas* and are therefore highly political. For that reason, matters of the economy are often connected to ideas about **freedom**. Countries that embrace 'political' freedoms and consequently refrain from interfering in people's opinions or organizations, also tend to hold back in matters of the economy. On the other hand, a country that embraces 'social' freedoms, might regulate matters of the economy with the purpose of a 'fair' distribution of wealth which may leave people little freedom to determine that for themselves. Governments often try to find the middle ground.

The road to serfdom or freedom?

Economist Friedrich Hayek is one of the godfathers of neoliberalism, advocating free market in *The Road to Serfdom* (1944), with the argument that state control of economic decision-making would lead to oppression of freedoms. Economist and Nobel prize winner Joseph Stiglitz argues in *The Road to freedom* (2024) that neoliberalism has led to the freedom of a few to oppress the many, and that the state needs to play an active role to guarantee civil liberties.

Market and trade

Rare is the situation that a person or household or community is completely self-sustainable. The same applies today to states: few, if any, have all the wealth, including the human resources, to meet the needs of its population. Usually, there is an imbalance between what is produced and what is needed. Exchange, or **trade**, is a way to compensate for this imbalance: what one needs is imported from elsewhere, and what one has in surplus can be exported. Trade has always been a part of humankind, and the many ancient trade routes across continents and seas show that consumptive needs were such that it paid off to get the wanted goods from afar.

The imbalance between that which is produced and that which is needed could be compensated for by **diversification**, that is to generate as many different types of products as possible to reduce the dependence on importing what is lacking. However, some economic theories argue that diversification weakens one's economic position, and therefore advocate the opposite, **specialization**: a country should focus on its primary resources or production capabilities and use it for export, the proceeds of which can then be used to buy and import all the goods the country needs. For that reason, countries like Egypt and Uzbekistan converted much of their agriculture to cotton in the 1950s, Vietnam to coffee in the 1980s, and so on. Specialisation also contributed to an increase in global trade: for instance, Taiwan is one of the few producers of semiconductor chips and is the main exporter of these chips across the world just like Brazil is the world's number one exporter of soybeans (60% of the world trade).

Rentier state is the name for a state whose income relies almost exclusively on the export of a single product for which little labor is required, like oil or gas. Such a state is said to live of the rent revenues of that product. When the income is such that no national production is needed (because the 'rent' income is so high that everything can be bought), then the 'rentier' situation is considered disruptive for the domestic economic situation, and often also for the social-political situation.

The result of an imbalance between what people have and what they need creates a **market** that is driven by supply and demand. The changes in supply and demand influence the price of the commodity at hand. If the demand for a product increases, but supply cannot keep up with demand, the price that consumers are willing to pay will rise. This mechanism can even itself out in time, but in complex societies states will often feel the need to interfere with the market: governments may stockpile certain products or set prices, raise tariffs against foreign goods or provide subsidies.

Impact of a global economy

The increasing interconnectedness of economies today has had an impact on the world in unprecedented ways, both positively and negatively.

The main example of the negative impact is that interconnectedness can also lead to interdependence. This showed in the financial crisis of 2008, which was sparked by defaults on subprime mortgage loans in the United States which triggered a near meltdown of banking systems across the world. Another example is the climate. The more companies rely on importing and exporting across the world, the more the transports needed for that will have an impact on the climate. The so-called carbon (or environmental, or energy) footprint has become the indicator of such an impact. With increasing concern about climate change, pressure has mounted on consumers as well as producers to be careful of that footprint.

Belt and Road Initiative

For centuries the 'Silk Route' existed across Asia, consisting of myriad routes linking up to a commercial highway connecting Eastern Europe with Central and Eastern Asia. In 2013, China coined the term 'Silk Road Economic Belt' (later: 'Belt and Road Initiative') for an extensive program of investments and development with numerous countries in Asia, Africa and Europe, creating a network of transport and cooperation.

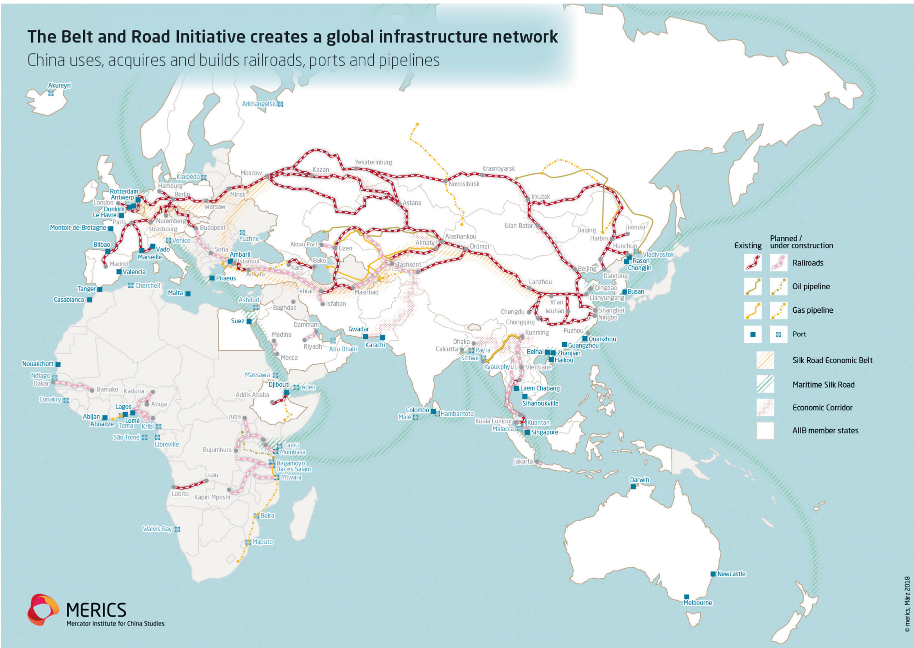

Figure II.2.1 China Belt and Road Initiative

The global economy also has its advantages. The main advantage is for companies: they have easy access to resources, parts and production, and they have more flexibility in allocating production. For instance, they can move their entire enterprise to another country because the local salaries or legal environment there are considered more beneficial. While this will create job opportunities in the new countries where production facilities are started, it also creates unemployment in the country that is being left. Another advantage of the global economy is the wide availability of products. This has contributed, for instance, to an increase in food production that, together with agricultural innovations, allowed for sustaining a rapidly rising world population.

Ukraine, the world's granary
Ukraine is one of the largest exporters of wheat and barley in the world. Countries like Egypt, Indonesia, Bangladesh, Pakistan import 25-50% of their wheat from Ukraine. These supplies suffered greatly from the 2022 Russian invasion in Ukraine. The shortages were supplemented by other wheat-exporters, including Russia, that increased their exports.

The global economy has also raised the concern that certain products and brands may lose their typical 'national' identity once they are being reproduced across the world (like French wine and Greek feta cheese), or when they are assembled outside of their country of origin (like Swedish Volvo and Japanese Nintendo). For some of these products, the national brand is considered of the essence, causing the rise of lobbies to protect the national naming of these products.

It may look like individual consumers are crushed in these global developments, but the contrary is true. Consumers have united in international pressure groups that boycott certain products to force companies to change their methods. This is happening in the case of coffee, for instance, where consumers are encouraged to only drink coffee from companies that treat the coffee workers fairly. Similar actions are undertaken against the sweat shops in South-East Asia that produce the clothing that is sold at low prices in Western stores. Such pressure is also increasingly exerted for political reasons: international companies like McDonalds and Starbucks have been boycotted for their commercial ties with countries like China and Israel.

Economy and democracy
During the 1990s, there was a general assumption among mostly Western countries that democracy was the prerequisite for a functioning economy. Southeast Asian countries, however, showed that a flourishing economy could be achieved without fulfilling the conditions of democracy.

Criticism

Economic thinking has received its share of criticism from economists and outsiders. Two types of criticism will be discussed here.

The first criticism regards the assumption that people act as the *homo economicus*, which refers to economic decision-making based on reasoned calculations. This assumption has allowed economists to construct models based on what were considered logical decision processes. The so-called behaviorists, however, have indicated the erratic and sometimes even irrational processes of human thinking, including in economic practices: their decisions are often based on instinct, bias, and emotions. The behaviorists have shown that rational decisions are usually the result of slow thinking processes while the emotional and instinctive decisions are made quickly. As a result, people do not necessarily act consistently and rationally in their economic actions: they may spend an extra hour in the car to drive to a store on the other side of town for a relatively small price advantage, or take high insurance for relatively cheap appliances, or are more willing to spend one hundred euros on several products that are on sale than the same one hundred euros on a single quality product that they really need. These 'cognitive illusions' appear to be the prime drivers of economic behavior rather than calculated rational consideration.

Brain 'kinks'

Professor Kahneman (died 2024) introduced the notion of universal brain "kinks" to indicate inconsistencies in economic thinking. Famous is the kink of 'loss-aversion' which means that loss hurts more than gain – for instance, the loss of $100 seems to hurt about twice as much as the gaining of $100 brings pleasure.

(Daniel Kahneman, *Thinking, Fast and Slow*, 2011)

Another criticism of economics as practiced today is that it deviates from its original goal, that is: organizing behavior to make people more comfortable and improve their well-being. Rather than being a means to an end, critics argue that economics has shifted to being the end itself. Their concern is that there is an increasing tendency to use the notion of 'economic growth' as a goal and justification in its own right, instead of using economics in such a way that it satisfies the needs that sustain the individual, community, or society. To put it in simple terms: greed has become the ingredient for what has become an immoral economy. One of the results of such economic systems is the increasing divide between the rich and the poor. Several economists, like Piketty and the Nobel prize winners Joseph Stiglitz, and Daron Acemoglu and Simon Johnson (who shared the 2024 Nobel prize), have pointed out how this inequality can become a source of disruption in today's democratic societies.

"When plunder becomes a way of life for a group of men living together in society, they create for themselves in the course of time a legal system that authorizes it and a moral code that glorifies it."

(Frederic Bastiat, economist, 1801-1850)

These two issues – the paradoxes of human (economic) behavior, and the misuse of economic systems – have been food for political debates about the question of how to distribute wealth fairly. But this question has also become a global challenge: how can one balance the coexistence on the same planet of extreme richness and poverty, and of food waste and famine? This will be partly discussed in the chapter 'Sustainable Development.'

Further reading

Daron Acemoglu and Simon Johnson, *Power and Progress: Our Thousand-Year Struggle Over Technology and Prosperity*, PublicAffairs, 2023

David N. Balaam, Bradford Dillman, *Introduction to International Political Economy*, Routledge, 2019

Abhijit V. Banerjee and Esther Duflo, *Poor Economics: The Surprising Truth about Life on Less Than $1 a Day*, Penguin, 2012

Thomas Piketty, *Capital in the 21st Century* (transl.), Brilliance, 2014

Kenneth A. Reinert, *An Introduction to International Economics. New Perspectives on the World Economy*, Cambridge University Press, 2020

Joseph Stiglitz, *The Road to freedom, Norton & Co,* 2024