

Econ 337

Final Exam Topics

1. Background

Hobbes: self interest and rationality; state of nature; agreement to form a state to constrain individual selfishness.

Locke: natural law philosophy; laws of nature, contract theory of the state; but state formed to better protect natural rights.

(Note: this material relates also to the issue of the Scottish social philosophy of Hume and Smith—see below)

2. Mercantilism

Basic ideas of Mercantilism: concept of wealth; emphasis on trade balance; analogy with a household; restrict imports, promote exports; trade a zero sum game.

Mercantilist writings: proposals of Von Hornick and Thomas Mun.

Mercantilist policy in France (Colbert) and England.

Mercantilism and monetary theory—early quantity theory; money and the price level.

Criticisms of Mercantilism: Hume and Specie flow mechanism; Smith on allocation of resources and gains from trade. Trade not a zero sum game.

3. Physiocracy

Basic concept of the “natural order;” natural law concepts; role of reason and investigation; ordering of society according to natural laws.

Concept of “net product;” productive and “sterile” classes.

Tableau Economique: be able to explain in detail to show flows of money and goods; how the system can reproduce itself; the net product supports the landowners; artisans are sterile etc.

Policy implications that were drawn from this analysis: rents, taxes, agricultural improvement, laissez-faire, opposed to Colbert.

Note the Physiocratic elements that remain in Smith’s discussion of the natural order, productivity, etc although Smith rejects the idea that only agriculture is productive.

4. Smith

Background to Smith: Scottish Enlightenment, work of Hutcheson and others. Characteristics of Scottish social theory: human nature the same, institutions differ; people are both self interested and social beings; public institutions emerge spontaneously not by contract or agreement. Hume and Smith's *Theory of Moral Sentiments*. Differences from Hobbes and Locke (see above)

Smith's *Wealth of Nations*:

Definition of wealth—per capita GDP

What generates wealth—productivity of labour and proportion of labour force used productively
Division of labour—leads to huge increases in productivity of labour; division of labour increases skill, saves time, and leads to introduction of machinery. Example of pin factory.

Division of labour from propensity to truck barter and exchange. Arises out of self interest not due to any overall foresight or plan. Leads to vast amount of specialization and exchange. Example of the simple wool coat. Works via self-love not benevolence.

Division of labour limited by the extent of the market

Specialization and exchange lead to the development of money.

Issue of price. Water diamond paradox; real and nominal prices; “labour commanded” as an invariable measure of value.

Exchange value—in the “early and rude state of society” determined by relative labour inputs. With capital and private property in land determined by relative cost of production. Issue of rent here.

Natural price and market price. Discussion of market adjustment to natural price. Factor mobility. Monopoly.

Wages: bargaining, bargaining power of employers, constraints on that power are subsistence and demand for labour. Labour supply—population, subsistence and infant mortality rates. Labour demand—wage fund theory. Be able to explain the concept of the wage fund, what determines it, how it can be changed over time, etc. Long run trend of real wages with progress.

Profits: interest rate plus a risk premium. Tends to decline with capital accumulation. Profits high where capital is scarce. Profits fall with accumulation as real wages tend to rise and there is increased competition. Incentives to create monopoly.

Rents: due to scarcity of land. Price determined in this chapter. Tend to rise with progress due to increased population and demand for agricultural goods.

Interests of the three classes of society and their influence on legislation.

Capital accumulation: necessary prior to division of labour. Lack of capital the main constraint

on the division of labour. As capital accumulates can take division of labour further, increasing productivity, and creating possibility of more capital accumulation.

Security of property, thrift, saving, and productive investment.

Productive and unproductive. Distinction based (1) on what makes a return; and (2) tangible goods not services. Problems with latter definition.

Concern with prodigality—prodigality of the state. Unproductive labor that has to be supported by others.

Concept of the more or less productive forms of investment; natural order of investment. Concept of the system of natural liberty, let individuals invest where the return is highest; invisible hand. Govt. should not try to allocate resources.

Critique of Physiocracy and Mercantilism. Theory of mutual gains from trade on the basis of absolute cost differences.

Role of Government: Defense; justice system; education of youth; public works for the facilitation of commerce. Concept of a public good. Issues of incentives, charges, taxes.

5. Malthus

Issue of perfectability of society, substitution of platonic for physical love. Godwin.

The two basic postulates. Be able to state these fully and correctly. Implications of the postulates. Formalization in the hypotheses of geometric and arithmetic ratios. Implication in terms of the view of agricultural possibilities.

Positive checks to population—applied to laboring class mostly. Works via lack of subsistence pushing up mortality rates. Infant mortality, illness, poor health, shorter life span. Misery.

Preventive check—applied mostly to lower middle classes—fear of losing social status might lead to delay of marriage or in abstinence. Later marriage, lower birth rates. But can lead to vice.

Malthus' view of current situation in England and view of tendency of wages to subsistence

Role of landed class, unproductive consumption, and population.

Debate over population theory—Senior, Mill, Torrens.

Malthus on Rent and on Gluts.

6. Utilitarianism

Bentham and utilitarian philosophy

Psychological utilitarianism (hedonism), people seek pleasure and avoid pain

Ethical Utilitarianism, happiness is the moral end.

Principle of Utility—the greatest good for the greatest number

Various dimensions of pleasure and pain

Problem of interpersonal comparisons

Utilitarianism and Classical Economics—Mill.

7. Ricardo

Theory of Value: labour theory, direct and indirect labour. Translation into monetary amounts: relative prices depend on relative wage and capital costs. Rent not included as rent is price determined. Problems with this: if wage rates change this will disturb relative prices without any change in the quantity of direct or indirect labour, if labour to capital ratios vary. Ricardo argues such disturbances account for only about 7% of relative price changes. Assumes all changes in relative prices due to changes in real costs of production. Disputes Smith's idea of labour commanded as an invariable measure, but then assumes gold is invariable.

Rent and Diminishing Returns: Problem of extending agricultural production due to diminishing returns. Two margins: the intensive margin and the extensive margin. Diminishing returns on both margins. As cultivation is extended the rent that can be charged on intra-marginal land rises.

Markets: similar to Smith except upward sloping supply curve in agriculture so that the natural price of agricultural goods rises with output. Manufacturers have constant costs. Adjustment of market to natural price similar to Smith except for a greater emphasis on mobility of capital.

Wages: labour supply based on Malthusian theory of population and subsistence. Labour demand based on the Wage Fund. If wages go above subsistence population will grow.

Profits: Profits tend to fall with capital accumulation, but not for the reasons given by Smith. Real wages do not go above subsistence in the long run, and more capital investment should not decrease profits (Says Law).

The Corn Model: In a progressive state—capital accumulation, wage fund grows, wages go above subsistence, population begins to grow. Demand for food rises but agricultural output can only be increased at increased real cost. Relative price of food goes up, but as real wages cannot fall below subsistence the cost of the subsistence wage goes up and reduces profits. This will result in a stationary state with profits just covering the capitalists own consumption, wages at subsistence and with high rents. **DIAGRAM** of the corn model. Solution to the problem: remove the corn laws, reduce the price of corn and restore profits. Landlords are the villains of

the piece. Be able to compare Smith and Ricardo on what happens in a progressive state, why profits fall, and the political interests of the main social classes.

International Trade: Trade and specialization on the basis of comparative or relative price differences. Be able to demonstrate gains from trade on the basis of comparative cost differences.

Ricardo on Machinery: the machinery question. Ricardo's analysis of the introduction of machinery by utilizing part of a workforce to build a machine. Converts wage fund into fixed capital. Has a short run negative effect on the demand for labour. (Be able to present Ricardo's numerical example).

8. J. S. Mill

Distinction between laws of production and laws of distribution

Production: productive and unproductive labour; fundamental propositions concerning capital; productivity of labour and capital, skill and knowledge, division of labour, production on a large scale. Laws of increase: Labour, population and subsistence, but subsistence a "habitual standard;" Capital, thrift and savings, effective desire of accumulation; Land, diminishing returns in agriculture.

Distribution: Importance of property rights system. Does the existing system maximize utility? Alternatives, communism and socialism. Possible problems of such schemes in terms of incentives and government control over individual choice. Possible improvements to the existing scheme of property rights. Wages: population and wage fund. Subsistence a "moral" minimum. Emigration and colonies. Labour market and non-competing groups. Mills "recantation" of the wage fund. Rent, Ricardian treatment. Profit, abstinence theory of profit.

Exchange: Market price and natural price. Natural price is the cost of production (wages and profits) of the most costly portion. Rent an intra-marginal surplus. Cases where cost of production cannot apply, joint products and international values, go to demand and supply explanation.

Progress: Capital accumulation and technological change. Increasing returns in manufacturing but decreasing returns in agriculture. Ricardian model of the growth process. Stationary State, but may not be such a bad place to be. Moral improvement.

Role of Government: necessary and optional functions. Presumption of Laissez Fair, but application of the principle of utility to justify intervention. Protection of person and property, justice system, education and information, child protection, collective goods, public goods, regulation of natural monopoly, poor relief, colonies.

9. Say's Law

Basic idea of Say's Law, cannot be a general overproduction or underconsumption.

Bases of Say's Law: (1) savings and investment brought into equality by i rate adjustments: what is saved is spent; (2) demand for money only for transactions purposes: people do not hold money as an asset, no "hoarding."

Say's Identity: strict version of Say's law: full employment AGG S is always equal to AGG D. Money is only a veil, money economy works like a barter economy, supply is a demand, a demand is a supply. Dichotomization of the pricing process.

Say's Equality: Equilibrium version. Full Employment AGG S = AGG D, in equilibrium. Adjustment processes and links between monetary and real sectors. Direct mechanism or real balance effect, and indirect mechanism (real and market interest rates). Classical analysis of "commercial crises"

Monetary policy: Bullionist, moderate bullionist and anti-bullionist (real bills doctrine) positions. Tests for over issue of paper currency and issue of convertibility. Bank Charter Act debate, Currency school vs banking school. Currency school position won out. Linking of paper issue to gold reserves and convertibility. Goal was to stabilize the price level.

10. Classical Policy

Social policy issues: public health, factory acts, mechanization, poor laws, trade unions, Ireland, colonies.

11. Marx

Combination of classical economics, Hegel, and radical ideology.

Essentialist ontology: distinction between the phenomenal and the essential level. Prices and Values.

Capitalist commodity production: not $C > M > C$ but $M > C > M'$ where $M' > M$

Marxian value theory: Value is determined by the quantity of socially necessary labour time required to produce the commodity (measured in abstract homogeneous units).

Assume everything exchanges for its value—where does profit come from? If everything exchanges for its value then there must be an input into the production process that produces more value than its own value. This is labour power. Labour works for a given subsistence wage, the value of the goods in the subsistence wage good bundle is v (variable capital). But the length of the working day is greater than v . Labour works $v + s$ hours, and the value of s , surplus value, is expropriated by the capitalist in the form of profit.

Rate of exploitation, profits, and organic composition. Ways of increasing rate of profit.

Schemes of reproduction. Economy consists of two departments, capital goods sector and

consumption goods sector. Demands for capital and consumption goods have to equal output of each sector. Simple reproduction—a steady state with no capital accumulation. Expanded reproduction with capital accumulation—problem of balance between the two sectors and possibility of imbalance and crises. (Know how to present the numerical examples).

Transformation problem. Marx assumes everything exchanges for its value and that s/v and $s/c+v$ are equalized by labour and capital mobility. But this would imply that the ratio of c/v would have to be the same everywhere. Have to give up one of these equalities. Marx allows prices to diverge from values but in a systematic way and in a way that preserves the equality between total surplus and total profit. (Be able to show how Marx did the transformation using numbers). Problems with Marx's transformation. Values of capital goods not transformed, and rate of profit that is equalized is the value rate of profit not the money rate of profit. A proper transformation can be done but it does not preserve the equality between total surplus and total profit.

Laws of Motion: falling rate of profit and the reasons for it; impoverishment of the working class; absolute or relative impoverishment?; alienation and de-skilling of labour; reserve army of the unemployed; capitalist crises; concentration of capital; elimination of the small capitalist; the possibility of a revolution. Lenin and the Theory of Imperialism.

12. The Decline of Classical Economics

Analytical problems in value theory and with the wage fund theory.

Attacks by German Historical School and Marxists and Romantics.

New issues and problems relating to large firms, industrial structure, business cycles, labour unions.

But basic theory of the market mechanism retained.