

Tutorial letter 202/1/2015

History of Economic Thought ECS3705

Semester 1

Department of Economics

IMPORTANT INFORMATION:

This tutorial letter contains solutions to assignment
02.

BAR CODE

Dear Student

ANSWERS TO ASSIGNMENT 02 (first semester)

The correct answers were:

Question 1: [2]

Question 6: [4]

Question 11: [1]

Question 2: [4]

Question 7: [1]

Question 12: [1]

Question 3: [1]

Question 8: [3]

Question 13: [3]

Question 4: [1]

Question 9: [2]

Question 14: [4]

Question 5: [1]

Question 10: [3]

Question 15: [1]

We will briefly explain why the two statements given in each of the questions were correct or incorrect.

1.
 - a. Socialism was a reaction against the often deplorable condition of the recently urbanised working class of 19th century Europe in the wake of the Industrial Revolution.
Correct. The Industrial Revolution caused handicraft production to be replaced by mechanised production. Hence what was previously produced by a multitude of small artisans for a higher price was now produced by a small number of industrialists at a lower price. Consumers gained by getting goods at a lower price. But industrialists gained even more by sharing total profit among fewer producers, while workers often still earned subsistence wages. As John Stuart Mill in Brue and Grant (2013: 161) notes, “the mechanical inventions ... enabled a greater population to live the same life of drudgery and imprisonment, and an increased number of manufacturers and others to make fortune”. See also Guide (73-74).
 - b. Socialism, in all its forms, favours the abolition of private property in all types of goods.
Incorrect. For instance, Marxian socialism permits private ownership in consumer goods, though not in productive resources (machinery and land). Most (not all) forms of socialism view government as the suitable owner of productive resources (Brue and Grant 2013: 162-165).

- 2.
- a. According to guild socialism and worker cooperative socialism, management of industries should be entrusted to the producers rather than to government.
Correct. The guild socialists and worker cooperative socialists proposed that every worker be a part-owner of the enterprise for which he or she works. The formulation of economic policy however, is entrusted to government (Brue and Grant 2013: 162-165).
- b. According to Marx, the mode of production in material life determines the general social and political processes of life.
Correct. This is the basic principle of Marx's theory of history (see Brue and Grant 2013: 185-187).
- 3.
- a. According to Marx, the exploitation of workers occurs when the efficiency of production is low.
Incorrect. According to Marx's theory of exploitation, "[t]he exploitation of workers – the extraction of surplus value by capitalists – cannot occur when the productivity of labour is so low that the workers have to consume goods equivalent in value to their own output in order to survive." (Brue and Grant 2013: 189).
- b. Soviet Russia practised communism as Marx envisaged it.
Incorrect. No, Soviet Russia rather practised what the Brue and Grant refers to as Marxian socialism. Communism, as Marx understood it, referred to some kind of anarchist utopia, i.e. a society without private property and without government where each individual voluntarily shares his possessions with others. See Brue and Grant (2013: 163-164).
- 4.
- a. Marxian exploitation would cease when capital is nationalised.
Incorrect. Strictly speaking, Marxian exploitation lies in the exploitative nature of the employer-employee (owner-worker) relationship. The prevalence of that relationship is typical of large-scale industrial production. Since state ownership does not overturn industrial production or the employer-employee relationship, Marxian exploitation can strictly speaking also happen under state socialism (see Guide 77). When all productive assets are nationalised, the state becomes the "capitalist" which exploits its workers.

b. Marx believed that capitalists would not strive to mechanise, because mechanisation leads to a lowering of the profit rate.

Incorrect. This statement points to one of the so-called contradictions in capitalism: mechanisation lowers the profit rate and yet capitalists seek to mechanise even further. The reason is that, while the profit rate of the total business sector (capital as a whole) declines with mechanisation, the one firm can still gain profit at expense of the other by mechanising (Brue and Grant 2013: 193-196).

5.

a. The German historical school's economics is a brand of classical economics.

Incorrect. The German historicists were opposed to classical economics, in regard to both its method (abstract-deductive approach) and its policy prescriptions (laissez-faire). See Brue and Grant (ch. 11).

b. Mid nineteenth-century Germany had a liberal economy with little government intervention.

Incorrect. No Germany at the time had a highly centralised economy with lots of government intervention. Moreover, Germany was still predominantly an agricultural society with relatively little industry (see Brue and Grant 2013: 205-206). But once Germany started to industrialise around the second half of the nineteenth century, it fairly quickly overtook Britain in industrial output.

6.

a. German historicists advocated state interference to help Germany catch up with England in terms of industrialisation.

Correct. See Brue and Grant (2013: 206-209)

b. German historicists wished to arrive at empirically based regularities by studying history, rather than logically based regularities by deducing logical consequences from abstract first principles like a profit/utility maximising economic agent.

Correct. See the inductive-historical approach as explained in the Brue and Grant (2013: 207).

7.

a. The marginalists believed that prices are primarily determined by the forces of demand and supply.

Incorrect. The price theory of the marginalists is demand-oriented. This means that price is viewed as being primarily determined by demand (Brue and Grant 2013: 224-225).

b. Just like the classicals, the marginalists believed that exchange price is based on labour time used in production.

Incorrect. The marginalists did not approve of the labour theory of value, which linked the value of commodities to the amount of labour used in their production. They argued, rather, that the exchange price of a commodity is based on demand, which in turn depends on marginal utility (Brue and Grant 2013: 224-225).

8.

a. According to Marshall, two people with equal incomes will derive equal utility from using those incomes.

Incorrect. According to the marginal principle, the point at which decisions are made varies among individuals even if they are assumed to have the same income levels. This is because the people experience different degrees of satisfaction from obtaining income (Brue and Grant 2013: 295-297; Guide: 90).

b. According to Marshall, land is merely a form of capital.

Correct. See Brue and Grant (2013: 225; 310-311).

9.

a. According to Marshall, a firm's short-run supply curve registers its variable costs.

Correct. In the short run, variable inputs can be changed, but the fixed inputs cannot be changed. All variable costs have to be covered in the short run, but some of the fixed costs need not be. Therefore the firm's supply curve is based on the variable costs of production (Brue and Grant 2013: 303-304).

b. According to Marshall, producer's surplus arises because some producers would be willing to sell their products at more than the market price.

Incorrect. Producer's surplus arises when some producers would be willing to sell their product at *less* than the market price (Brue and Grant 2013: 305-307).

10.

a. Institutions refer only to organisational structures.

Incorrect. See Brue and Grant (2013: 397).

b. Veblen criticised industrial production for being geared towards making money rather than making goods.

Correct. See Brue and Grant (2013: 305-307).

- 11.
- a. According to Veblen, engineers are in cahoots with capitalists to form the technostructure of corporate capitalism.
Incorrect. See Brue and Grant (2013: 409-410).
- b. According to Galbraith, the productive and affirmative purposes of the firm enhance the importance and strength of the profit motive.
Incorrect. No the productive and affirmative purposes go against the profit motive. See Brue and Grant (2013: 417-419).
- 12.
- a. In Galbraith's theory, the "planning sector" represents the government.
Incorrect. No, it refers to the private corporate sector where "ownership and control are divorced" (Brue and Grant 2013: 417).
- b. Galbraith was in favour of anti-trust legislation as a way of ensuring that firms don't become too powerful and markets remain competitive.
Incorrect. See Brue and Grant (2013: 418).
- 13.
- a. According to Keynes, instability in total spending is mostly due to instability in the demand for consumption goods.
Incorrect. According to Keynes, instability in total demand is mostly due to instability in the demand for investment goods. See Brue and Grant (2013: 457), Guide (117-118).
- b. Keynes believed that public works programmes, a degree of wage and price control as well as careful monetary and fiscal policy making could stabilise total demand at a level somewhere round where full employment is obtained.
Correct. The statement is literally taken from the Guide (119).
- 14.
- a. Post-Keynesians regard inflation as a symptom of the conflict over income distribution.
Correct. See Brue and Grant (2013: 496).
- b. According to New Keynesians, wage cost may be higher when the wage rate is at its market clearing (full employment) level than when it rises above that level, particularly when the cost of supervision is high and workers turnover great.
Correct. See Brue and Grant (2013: 499).

- 15.
- a. The Chicago school wished to use state intervention to serve the interest of large corporations.
- Incorrect.** The Chicago school did serve the interest of large corporations, but not by using state intervention. Rather it wished to do so by laissez-faire policies. See Brue and Grant (2013: 531-532), Guide (121-122).
- b. According to the rational expectations hypothesis, expansionary monetary and fiscal policy would only temporarily stimulate real output and employment.
- Incorrect.** The statement describes adaptive expectations. According to the rational expectations hypothesis, expansionary policies would have no effect on real production and employment at all – not even in the short run. The reasoning is that agents would anticipate the effect of such policies on nominal prices and thus immediately demand higher wages which would prevent real wages from falling. See Brue and Grant (2013: 542-543) and Guide (123-124).

Information about the examination

Start preparing on time for the examinations. Take note of the format of the exam paper, as explained in Tutorial Letter 101. The short questions (Section A) will be taken almost literally from the specific study outcomes for each of the study units as given in the Guide. Check all these outcomes; if you understand them and can give reasonable explanations for them, you are well prepared. As for the long questions (Section B), the best strategy is to compose 4 or 5 page summaries of each of the study units and then make summaries of these summaries and so forth until, from this process, you distil for your own understanding, the key points of the study units i.e. you understand for yourself why the key points are the key points. Best of luck and work hard!

Always feel free to contact us by phone or email if you have a problem with any section of the prescribed study material.

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