

## Written Exam Economics Winter 2016-2017

### History of Economic Thought

November 28 2016 at 10:00 am to December 5 2016 at 10:00 am

This exam question consists of 4 pages in total

Please note that the language used in your exam paper must correspond to the language of the title for which you registered during exam registration. I.e. if you registered for the English title of the course, you must write your exam paper in English. Likewise, if you registered for the Danish title of the course or if you registered for the English title which was followed by “eksamen på dansk” in brackets, you must write your exam paper in Danish.

If you are in doubt about which title you registered for, please see the print of your exam registration from the students’ self-service system.

***The paper must be uploaded as one PDF document. The PDF document must be named with exam number only (e.g. ‘1234.pdf’) and uploaded to Digital Exam.***

**A take-home exam paper cannot exceed 10 pages – and one page is defined as 2400 keystrokes.**

#### **Focus on Exam Cheating**

In case of presumed exam cheating, which is observed by either the examination registration of the respective study programmes, the invigilation or the course lecturer, the Head of Studies will make a preliminary inquiry into the matter, requesting a statement from the course lecturer and possibly the invigilation, too. Furthermore, the Head of Studies will interview the student. If the Head of Studies finds that there are reasonable grounds to suspect exam cheating, the issue will be reported to the Rector. In the course of the study and during examinations, the student is expected to conform to the rules and regulations governing academic integrity. Academic dishonesty includes falsification, plagiarism, failure to disclose information, and any other kind of misrepresentation of the student’s own performance and results or assisting another student herewith. For example, failure to indicate sources in written assignments is regarded as failure to disclose information. Attempts to cheat at examinations are dealt with in the same manner as exam cheating which has been carried through. In case of exam cheating, the following sanctions may be imposed by the Rector:

- 1. A warning
- 2. Expulsion from the examination
- 3. Suspension from the University for a limited period or permanent expulsion.

The Faculty of Social Sciences  
The Study and Examination Office  
October 2006

### **1. Das Adam Smith Problem**

The opening sentence in Adam Smith's *The Theory of Moral Sentiments* from 1759 reads "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it".

Early on in the *Wealth of Nations* from 1776 – in Book 1, Ch. 2 – the same Adam Smith writes "It is not from the benevolence of the butcher, the brewer or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages".

The seeming contradiction between the tones in these two quotes has been called "Das Adam Smith Problem". Do you think we have a contradiction?

### **2. The 93% Labour Theory of Value**

In *The Works and Correspondence of David Ricardo*, vol. II, p. 66 Ricardo remarks:

*"Mr. Malthus shows that in fact the exchangeable value of commodities is not exactly proportional to the labour which has been employed on them, which I not only admit now, but have never denied."*

Explain why – according to Ricardo – the Labour Theory of Value may not hold precisely. Is it fair to say that Ricardo may have believed in an empirical and not an analytical version of the Labour Theory of Value?

### **3. The Falling Rate of Profit**

According to Marx, it is straightforward classical economics that capitalists in their lust for profit will in the end drive the marginal rate of profit down and eventually destroy capitalism. Is that true?

### **4. Sunspots driving the business cycle**

According to Sandmo (p. 178) Jevon's sunspot theory has been characterized as "the most ridiculed idea of his life". Do you think that the idea that solar activity drives agricultural production which again drives the business cycle is ridiculous, wrong or plausible – or some combination of these?

### **5. A downward sloping supply curve.**

Several writers (Marshall, Wicksell, Joan Robinson and Edward Chamberlain) struggled with the possibility of falling marginal cost curves and downward sloping supply curves.

What was at stake – if we enjoyed increasing returns to scale, wouldn't we have to accept, at MC would fall with increasing demand? How did Marshall and Wicksell handle the issue? When we introduce imperfect / monopolistic competition, the issue appears to vanish, how and why?

## 6. Ordinal utility and welfare economics.

Pareto concludes in his *Manual of Political Economy* from 1909 (translated into English 1971), quoted from Sandmo p. 252 that

*"We will say that the members of a collectivity enjoy maximum utility in a certain position when it is impossible to find a way of moving from that position very slightly in such a manner that the utility enjoyed by each of the individuals of that collectivity increases".*

1) What do think of the term "maximum utility" in this context? 2) compare Pareto's dictum with Pigou's equally famous statement:

*"It is evident that any transference of income from a relatively rich man to a relatively poor man of similar temperament, since it enables more intense wants to be satisfied at the expense of less intense wants, must increase the aggregate sum of satisfaction. The old law of "diminishing [marginal] utility" thus leads securely to the proposition: Any cause which increases the absolute share of real income in the hands of the poor, provides that it does not lead to a contraction in the size of national dividend from any point of view, will, in general increase economic welfare" (Economics of Welfare, 1920, 4<sup>th</sup> ed 1932, p. 89).*

## 7. The relationship between the functional and the personal distribution of income.

Piketty and Zucman show in their *Capital is Back: Wealth-Income Ratios in Rich Countries 1700 – 2010*, QJE 2014 that  $W/Y (= K/Y)$  or  $\beta$  has increased after World War II. Are they right to argue that this has made the personal income distribution more uneven?

## 8. The IS-LM interpretation of Keynes' General Theory

In his (now) famous paper *Mr. Keynes and the 'Classics'*. *Econometrica* 1937, John Hicks sought to provide a formal model that should demonstrate the essence of Keynes' General Theory.

Hicks' paper is available in many places and may be downloaded from the *Resource page* on our Absalon.

1. Read Hicks' paper and explain the IS- and the LM-curves.
2. What is the interpretation of the point of intersection between the two curves? Sketch a Keynesian and a Classical set of curves. According to Hicks, which is the major difference between Keynes' model and the Classical model?
3. In class we discussed the causes of unemployment; all of you said that unemployment is caused by some kind of inflexibility in wage formation – were wages perfectly flexible, we would have full employment! Does that match Hicks' version of Keynes' model? Does it match Keynes' own version?

4. Later in the development of macroeconomics (most famously by Don Patinkin in 1956 and by Axel Leijonhufvud in 1968) it was argued that the Keynesian idea could be that wages are flexible but slow to respond to changes in demand and supply in the labour market. What do you think of that – as a description of reality and as an interpretation of Keynes' own arguments?
5. In 1978 Joan Robinson attacked Hicks' interpretation of Keynes by saying: "*J.R. Hicks was one of first, with his IS-LM, to try to reduce the General Theory to a system of equilibrium. This had a wide success and has distorted teaching of economics for many generations of students*". Explain and discuss that statement. (Hint: take into account Keynes' thinking about expectations as discussed in Sandmo' Ch. 15 on Keynes)