

Written Exam for the M.Sc. in Economics Winter 2013-14

History of Economic Thought

Final Exam

January 3, 2014

(3-hour closed book exam)

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.

I. **The Labour Theory of Value** (brief answers)

The classical economists from Adam Smith to Karl Marx subscribed to the Labour Theory of Value. Describe and explain that theory.

When David Ricardo elaborated upon the Labour Theory of Value, he encountered difficulties and ended up by proposing a modification later characterized as a “93 % Labour Theory of Value”. What was the problem with the original version and does Ricardo’s modification save the theory?

II. **The interest rate** (brief answer)

Is the interest rate positive?

III. **Cardinal and ordinal utility.**

Consider these statements from Edgeworth, Pareto and Pigou:

“Axiom. – Pleasure is measurable, and all pleasures are commensurable; so much of one sort of pleasure felt by one sentient being equateable to so much of other sort of pleasure felt by other sentients”. **Francis Ysidro Edgeworth**, *Mathematical Psychics* 1881, p. 59 – 60) (“translated” by Paul Samuelsson into “for Edgeworth utility was as real as his morning jam”).

“The utility, or its index, for one individual, and the utility, or its index, for another individual, are heterogeneous quantities. We can neither add them together nor compare them.....A sum of utility enjoyed by different individuals does not exist; it is an expression which has no meaning.” **Vilfredo Pareto**, *Manual* 1909, Eng. ed 1971 – quoted from Sandmo p. 251 where “ophelimity” has been changed into “utility”.

“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 aggregated 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, provided that it does not lead to a contradiction in the size of the national dividend from any point of view, will, in general, increase economic welfare.....Mill wrote: “Men do not desire to be *rich*, but to be richer than other men”” **Arthur Cecil Pigou**, *Economics of Welfare*, 1920, quoted from the 1952 ed.

Who argues for utility to be cardinal and who favours ordinal utility? Discuss the consequences of accepting cardinal and ordinal utility for economic policy related to government intervention in the personal income distribution.

Each of these writers either did work with indifference curves or had similar representations of utility and consumer choice. How would an economist working under the assumption of ordinal, respectively cardinal utility describe a movement from a lower to a higher curve?

