

History of Economic Thought

Re-exam 16.2.2024

Outline of solution

The answers should elaborate on the following points:

1. (a) For the pre-classical and classical writers, one may distinguish two different approaches to a treatment of the labour market, namely (1) the wage fund theory, according to which the number of workers employed and their wages were constrained by the available funds for hiring workers, and (2) the tendency of the wage rate to approach the subsistence rate, mainly as a consequence of the population dynamics. With the marginalists, the notion of a labor market with wages rates determined by marginal productivity of capital, was in particular put forward by J.B.Clark, followed by Wicksteed.

(b) In the Keynesian macroeconomic model, the approach to the labour market differed from the contemporary theory by taking into consideration the effects of wage rate changes on aggregate demand. As a consequence, the standard proposal to achieve equilibrium in the labour market and eliminating unemployment by reduction in the real wage rate would not be effective, since it would result in reduced consumption demand and thereby reduced demand for labour.

2. (a) With the classical writers, capital had the role of a monetary fund to be forwarded to purchase labour and other inputs in production, and the profits of the entrepreneurs were seen as a remuneration of the willingness to postpone consumption. With the neoclassic economists, the role of capital as a physical production factor came to the forefront, and its remuneration in the market was considered as the marginal return to this factor of production. The physical features of capital were emphasized by writers as Böhm-Bawerk and J.B.Clark.

(b) The capital controversy had its roots in considerations by earlier writers of the marginalist school about measuring the value of capital as an aggregate of physically distinct goods, in particularly in connection with the theory of interest rates. It emerged as a controversy due to the writings of Sraffa, who pointed out that the optimal technique of production may depend on relative factor prices, and that a given technique may be optimal with two different factor price combinations but not with combinations inbetween, giving rise to the so-called reswitching. Eventually, both parties accepted the possibility of reswitching, but the impact on subsequent research was small.

3. (a) The demand curve can be found in writings of the forerunners of marginalism, in particular in Cournot and Dupuit, but several other authors (for example Rau and Jenkin) used this notion, even to the extent that that the “Marshallian cross” was developed by other authors before Marshall. However, the connection between utility and demand curves was introduced by Marshall.

(b) The issues and effects on markets caused by external effects had been observed and treated by earlier authors, but Marshall gave the first coherent treatment and also introduced the terminology. In Marshall’s writings, they were seen as part of more general economic relations, involving both internal and external economic effects on the individual producer. An analysis of possible ways to combat the market failure connected with external effects was initiated with Pigou’s theory of taxation.