

Economics 493/593  
Fall 2008  
Solution to Midterm 2

1. (a) The market price is the actual price a good sells for on the market, and it is determined by supply and demand. The natural price is the price that provides the landlord, capitalist, and workers with rent, profit and wages equal to the socially average rate of rent, profit, and wages. It is a long-run price that is determined solely by costs of production.

(b) Wages would differ across occupations due to:

1. Agreeableness. The less agreeable the work, the higher the wage.
2. Cost of acquiring skills and knowledge. When more investment is required, wages will be higher.
3. Regularity of employment. Less regular employment is more risky and hence needs to be compensated at a higher rate.
4. Level of responsibility. The more responsibility, the higher the wage.
5. Probability of success. The lower the chance of success, the higher the wage

2. Malthus believed that workers were hired only if they produced more than they took home in pay, i.e. if there was profit, so that workers alone did not make enough to consume all of output. That left two other classes, capitalists and landlords, to make up the difference. Capitalists could not be depended upon because they were too busy accumulating capital (and saving to do so) to consume enough, so that left the landlords. The policy conclusion was that the corn laws were desirable because they caused higher rents, and the higher rents allowed landlords to consume lavishly thereby preventing recessions/gluts.

3. Bentham said that if something adds more to pleasure of poor than detracts from pleasure of rich, then the government should do it, that is, government should maximize happiness. How to measure happiness? Said that wealth = happiness (or at least, it is the best measure).

Bentham believed that if you double wealth, you less than double happiness and this is what leads him to promote the redistribution of income. But he doesn't advocate full equality since taking wealth away from the rich detracts from their security (inducement to work). He said that when equality and security are at odds, security should prevail.

[Looking for a discussion of the following points] Unlike Bentham, Mill did not believe that all motives could be reduced to self-interest, this only dominates economic behavior, Mill did not believe each person best judge of own utility, he believed there was a higher order on which to judge actions – quality matters (push-pin not as good as poetry).

4. The key elements of Marxian Socialism are the use of Ricardo's labor theory of value (which leads to class conflict since labor is the source of all value), and he adds a theory of exploitation to this. It's based upon a materialistic, evolutionary view of history. IN each historical epoch, the method of production and exchanges, and the resultant social organization are the basis for the laws, politics, culture, institutions, etc. As each develops productive forces and class relations become a barrier to future progress, and class struggle produces a higher evolutionary form of production.

The six stages are primitive communism (no class, common ownership, group activity for survival, low efficiency, little surplus so exploitation is impossible), slavery (have class conflict here, permitted production to increase, but eventually became a barrier to further progress since slaves aren't particularly motivated to work), feudalism (unique in that exploitation is very clear, work part time for self – hence productivity is higher – and part time for overlord, Time spent working for self very productive, but overall not better off than under slavery, still at subsistence, so worker doesn't benefit from higher output), capitalism (workers are exploited as explained in his theory of exploitation given in class, i.e. by selling labor power rather than labor time, and the inherent class struggles in this mode eventually lead to its downfall), socialism (private ownership n consumer goods, capital and land owned by government and regulated, production is planned, profit motive replaced), communism (socialists say “from each according to ability, to each according to works,” while communists say “from each according to ability, to each according to need”).

Marx was heavily influenced by Smith and Ricardo, respected them, and he considered Mill an intellectual opponent. But for the most part, he felt that all economists (except perhaps Smith) did not have an historical view and hence missed the essential elements of the capitalist mode of production. They also believed all activities could be reduced to a series of exchanges and that led to two errors, (1) the belief that capital is universal in al production (i.e. ownership rights, not the equipment itself), and (2) all economic activity can be reduced to a series of exchanges.

5. The key here is to recognize the difference between labor power – the ability to work – and labor time – the actual process and duration of work. Labor power is bought and sold on the open market and because of the reserve army of the unemployed, the value fell to subsistence (where subsistence is socially defined). You can only have exploitation of the value of labor power is less than the actual labor time (e.g. value of labor power is 6 hours per day, and you work 14 hours, the extra 8 hours is the source of the exploitation).

6. Senior wanted to separate the science of economics from the value judgments. Thus, he advocated sticking to positive analysis and avoiding the normative, but he didn't always follow his own advice. In this regard, he felt that every person desires additional wealth for as little sacrifice as possible, i.e. that they were rational maximizers.

Initially, prior to 1830, Senior had a lot of compassion for the poor. But from 1829-1842, a long series of labor unrests, attempts to unionize, strikes, riots, sabotage, etc. changed his view. He said capitalists had a fixed wage fund to distribute across all workers, and

the size of the fund depends upon the worker's productivity. Thus, increasing productivity or reducing the number of workers was the only way to help them.

How to increase productivity? Two ways. First, remove all restriction of free trade and the accumulation of capital, Second, abolish the poor laws. The laws lead to the attitude that a person has a right to live even if no work is performed and this diminishes effort.

To solve this, in 1832 appointed a member of the Poor Law Inquiry Commission, and the commission passed a new law (in 1834) that said:

1. A worker must accept any job offered, regardless of conditions or pay.
2. If a person cannot find work, give them just enough to survive.
3. The amount should be less than the lowest wage on the market in order to motivate a person to seek work without concern for pay or conditions.