

Study Guide: History of Economic Thought

Fall 2018 edition

Chapter I: Introduction

Pre Chapter II:

Classical Economics: The state as a big house.....

Medieval Economics: Just price theory

Neither of these topics is covered in the book. The state as a big house is important, but only as it relates to other topics.

Be SURE to understand just price theory, why they had it, and why they couldn't see what a market price was (thick/thin markets). Just price theory has a very long history, and is still believed by the majority of non-economists

Chapter II: Mercantilism

Know the historic background of Mercantilism (I covered this in more detail in class than the book did), including specism and bullionism, the rise of the nation state and professional gunpowder armies, etc.

Know all the tenants of Mercantilism. Also know the underlying philosophical basis of it (zero-sum trade, the state, etc.)

Know the policies that flowed from it, and the results.

Know Davenant, Colber, and Petty. You can skip Malynes and Mun.

Know why Mercantilism is still a powerful idea in Political Science, International Relations, and for practicing politicians.

Chapter III: The Physiocrats

Know the historical background – what the French physiocrats saw that the English Mercantilists did not

Know the Tenants of the physiocrats

Know the basics of Quesnay and Turgot

You may skip the circular flow they developed (know that they did so though)

Know the tenants that became lasting contributions.

Chapter IV: The Classical School – Forerunners

Know the basics of the history of the time: Versailles and the French revolution, and the English reaction to it

The influence of Newtonian Physics, and the Early Industrial Revolution

Know the Major Tenants of the school

You do not need to know any of the figures for this period, or much about their theories, it was all superseded by Smith. I went over this chapter quickly, the main thing is to know how the physiocrats, industrial revolution, Newton and the French Revolution all served to move English towards classical thinking, as exemplified by.....

Chapter V: The Classical School, Adam Smith

Know everything I said about Smith, and everything in the chapter.

Also, know everything in the chapter, as well as everything I said about Smith in class.

Chapter VI: The Classical School, Thomas Malthus

Know the corn laws

Know the intellectual settings, Godwin and Condorcet (I went over this part fast in class, be sure to know it for the exam)

Know Malthus's Population Theory,

Why population grows, productivity diminishes, and population must be "checked". Why we can't control population voluntarily. The law of diminishing returns.

You may skip the theory of "Gluts", I will take it up again in later chapters.

Chapter VII: The Classical School, Ricardo

Explain the issue, and Ricardo's position on, the currency question

The theory of diminishing return on Rent

Why the price of grain is determined by rent, not vice-versa

Why there is a diminishing

I covered this quickly in class: Know Ricardo's model, go through it as given in the book...

Know about exchange value, and relative Prices

The beaver-deer problem

You may skip Ricardian equivalence for now...

The distribution of income

Wages, Profits and Rents

Be able to explain the graph given in class

What are the policy implications of all this?

Also, know the theory of comparative advantage

Why it was so influential

Chapter VIII: The Classical School – Bentham, Say, Senior and Mill

Bentham

KNOW UTILITARIANISM

Theories of it, (hedonism, pleasure/pain, etc.)

Diminishing marginal utility of Money

Cardinal and ordinal measures of Utility

"the greatest good to the greatest number of people"

Implications of, and criticisms of, utilitarianism

Say

Know Say's law, why he believed it, and others did

Know Say on Monopoly

Senior

Know positive and normative science

Abstinence as Postponed consumption

Productive labor vs. Smith's "unproductive services"

Mill

The intrinsic value of moral laws vs. the pure utilitarian thought

Mills on Production (labor, land, capital)

You can skip Mills on income distribution, the wage fund

Skip him on Exchange

And skip him on everything else as well

NOTE: Mills is an important figure, just getting dropped because of time constraints

Chapter IX: Socialism

Xxx

Xxx

Xxx

Xxx

Xxx

Xxx

Chapter X: Marxism

Know everything I said about Marxism, as well as everything in the chapter.

Also, know everything in the chapter, as well as everything I said about Marx

Sample Questions:

Q. Explain Cournot's (French, 1801 -1877) theory of monopoly. (Hint: the French spring water example: graph the Demand and marginal revenue curves, and the Total revenue curves)

Q. Explain Johann von Thunen's (German, 1783-1850) theory of agricultural location. Give examples of different products, and explain why they will be produced in different regions. Be sure to explain what the important variables are that drive the model.

Q. Explain why the classical school of economics thought that price was determined by supply, and the early marginalists thought it was determined by demand.

Q. Using Friedrich von Wieser's (Austrian, 1851 -1926) theory of "opportunity cost", explain the "Broken Window Fallacy" of Frederic Bastiat (French, 1801-1850). Why does this mean that Japan's recent Tsunami is NOT going to raise Japan's GDP?

Q. Graph out Edgeworth's contract curve, using his version of indifference curve analyses, in a Robinson Crusoe and Friday economy. Be sure to label your graph clearly, and to explain what it represents.

Q. Explain what product differentiation is, and how it led to Chamberlin's theory of Monopolistic Competition. Be sure to graph it out, and clearly explain the graph.

Q. Give a brief discussion of what various economists thought interest rates were, and how they were important in the economy. (Hint – Classical economists and rent, "surplus value and exploitation", Austrians and inter-temporal substitution, and the neoclassical views of Wicksell and Fischer)

Q. According to Marshal, what determined SUPPLY? **THEN EXPLAIN, WHAT,** according to Marshal, determined DEMAND?

Q. Explain Oscar Lange's (American/Polish, 1904 – 1965) theory of how a centrally planned economy could efficiently allocate resources and set prices even when the means of production (capital) was not privately owned, and why this would be more fair to workers, **THEN EXPLAIN** Ludwig von Mises's (Austria/America, 1881 – 1973) criticism of socialist planning – i.e. why Mises thought central planning *necessarily* could not work.

Q. Explain Wicksell's (Swedish, 1851 – 1926) theory of monetary theory – be sure mention his views on price changes, the “natural and bank interest rates”, and how they create cycles, **THEN EXPLAIN** Irving Fisher's (1867 – 1947) theory of Monetary policy. Be sure to mention the quantity theory of money, his theory of interest, Demand deposits, and the Fisher effect.

Q. Why did the Mercantilists favor large populations and low wages? Colonies? Bullionism?

Q. What problems did Colbertism have in practice? (be sure to describe some of its policies, before you talk about how they caused problems). How did Colbertism contribute to the thinking of the Physiocrats?

Q. Compare and contrast the thinking of Colbert and Turgot. On what things did they agree, and on what ones did they disagree (mention both philosophy, and policy, if you can)

Q. In what respect were the classical economists similar to the physiocrats, and in what way were they different?

Q. Why did Smith argue that wages could vary in society? What were the five things he listed as making wages differ. Also, why did he argue that higher wages could make society MORE productive, and firms MORE profitable?

Q. How, according to Smith, does the pursuit of private gain lead to the social good. Why did Smith argue that this meant that private market economics made people MORE moral, instead of less so.

Q. What were the Poor laws? What arguments were their for or against them, from the standpoint of RICARDO, MALTHUS, the SOCIALISTS, and the MARXISTS.

Q. What was Malthus's theory of Population? Why did he argue that it had always held, and would always hold – and how did it lead to the IRON LAW OF WAGES.

NEW QUESTIONS

Q. Why did Smith argue that more trade would lead to greater specialization, and more capital, and thus more wealth. How did this differ from Ricardo's theory of why trade was good?

Q. Why do many people argue that the modern Environmental Movement is “neo-malthusian”?

Q. Why is Mercantilism still so influential in Political Science? What difference do mercantilists have in their view of trade from mainstream economics?

Q. According to Ricardo, who got the surplus, and why? According to Marx, who got it, and why?

Q. Are market interests harmonious or conflictual, and why? Why did the economists and socialists disagree about these things?

Q. Explain the wage fund, and be sure to be able to explain why it was backwards looking, instead of forward looking.

Q. Why did the physiocrats believe that all value came from land. Marx believed from Labor. What other theories of value were out there?

Q. Why did everybody try and develop a theory of value. Do people (non-economist) believe in a fixed or true value, or in market prices?

Q. What changed in France between Colbert and Turgot, that one was a mercantilist, and the other a physiocrat.

Q. Why did Marx believe “the worse, the better”?

Q. What were Marx’s six stages of history. How did they come about.

Q. Why did the mercantilists favor a large population, low wages, and NO social spending to help the poor? This answer depends both on what the mercantilists believed about the economy, and their value system.

Q. What was bullionism? What role did exports, imports, colonies, wars, tariffs, and taxes in this doctrine.

Q. Why did the physiocrats speak of a “natural order” in the economy, yet they were strongly supportive of an absolute monarchy?

Q. How is the physiocrat concept of “circular flow” similar to the surplus?

Q. What was smith’s theory of value in a primitive, and an advanced, economy?

Q. What determined price, according to Ricardo (There are several things that did so)

Q. What was the history of the world, before Malthus, that caused him to believe what he did?

Q. Why did Malthus support tariffs on imported grains, why did the Mercantilists. Explain their differing views on population

Q. What is a normative science, and what is a positive science.

Q. What was Ricardo's theory of diminishing returns, and rent. Why did he conclude that all income from a rise in the price of grain would go to landlords?

Q. Explain Exchange value and relative prices, according to Ricardo.

Q. Know the theory of comparative costs. Really, know it well....

Q. What is Utilitarianism. What were/are the major objections to it? Why has utilitarianism died as an economic theory, but it is still influential in politics.

Q. What is Say's law?

Q. Socialists were concerned with class interests, government, cooperation vs. conflict, and historic inevitability. How did the different socialists take different views on all these questions, and what different policy prescriptions did that lead to.

Q. "Private property is a social construct, and eliminating it will lead to happiness". Discuss.

Q. Compare and contrast the socialism of Foriaiu and Owens.

Chapter 11: The German Historic School (GHS)

- Why did the German Historic School Stress interdisciplinary studies, vs. Why did the British method put the primacy on Theory?
- Why did so many early American Economists study in Germany
- What types of Economists did the German Historic School seek to create?
- How did the GHS indirectly lead to “Austrian Economics”

Sample Questions:

- Q Why did the GHS have a large impact on the early American Economists?
- Q How did the GHS help to lead to the Austrian School of Economics as a distinct, separate school?
- Q Why did the GHS ultimately disappear?

Chapter 12: Early Marginalists

- What were the problems with Classical Theory by the 1850s?
- What were the social problems classical theory ignored?
- How did the early marginalists shift focus from supply to demand?

- What were the basic Tenants of the early marginalists?
- How were they different from the classical economists?

Cournot: Didn't cover in class, you can skip

- Von Thunen: What was his location theory
 - Be sure to be able to explain the basics of his theory
 - What was the METHODOLOGICAL importance of his work (two variables, simple model, could be expanded)
 - Which added richness to the first simple model
 - And it could be compared to the real world

Q The early marginalists did a “bottom-up”, rather than “top-down” approach to economics, that was different than the classical school. Explain what this means, and why it allowed economics to start progressing as a social science.

Chapter 13: The Marginalist School I: Jevons et al

- Who was Jevons? Why was he important?
- Jevon's theory of diminishing marginal utility
 - (Not just for money, as Bentham had said, but for everything)
- Jevon's method of graphing out the value, and disutility, of work
 - Jevon's solution to the Water-Diamond Paradox

Rational Choice: The equimarginal Rule
Jevon's on Work/Leisure

- Mengor: Founder of Austrian Economics
 - How did he develop his theory of marginalism different than Jevons?

- The theory of imputed value
 - How did it unify the theory of labor, capital, and land?
 - Extended marginalism into the productive process.

Disproved the Iron Law of Wages

Weiser and Opportunity cost

Subjective value to the utility/disutility of work

Thus the cost of production is also subjective...

Bastiat:

That which is Seen and Unseen – The broken window fallacy

How does the broken window fallacy fit into/damage

Keynesian economics?

Theory of Interest (premium theory of interest)

Q. What is “the seen and the unseen” of Bastiat? How does it lead to the broken window fallacy.

Q. How did the Austrian’s extend subjective value into the production function?

Chapter 14

Edgeworth and Clark

Indifference curves

Mostly skipped this chapter

Chapter 15 Marshall.

You should know everything Marshall said.

Anything that Marshall said, you should know.

Chapter 16 Monetarists; Fisher and Wicksell

Know just the Basics of Wicksell

Know Fisher’s view of money and interest rates.

Q Wicksell thought that there were two interest rates, and that this caused the business cycle. In one paragraph, explain this theory.

Q How did Wicksell think the money supply should be managed (hint – world currency)

Q What is a gold standard, a bi-metal standard, and a basket standard, as it relates to currency? Why would you want/not want any of them.

Q Explain Fischer’s view of interest rates.

Q Explain Fischer’s view of the money supply, BEFORE the 1929 crash. Explain Fischer’s view of fractional reserve banking AFTER the 1929 crash, and why/how we should move to a different banking system.

Chapter 17: Departures from pure competition

— Why by the 1930’s did economists believe pure competition wasn’t always true?

- _____ Historic background: (trusts, economies of scale)
- _____ Theoretical insights, such as
- _____ Sraffa: the Theory of Natural Monopoly
- _____ Declining marginal costs over a long range of production
- _____ Individual demand curves for firms
- _____ Two ways to raise profits — one creates less competition (how?)
- _____ Chamberlin: Monopolistic Competition
- _____ Product differentiation
- _____ Production where AC are NOT minimized
- _____ Industry and economy wide overproduction
- _____ Know Chamberlin's model
- _____
- _____ Robinson: Monopsony
- _____ Again, know Robinson's theory of monopsony

Q Is product differentiation a good or bad thing, on balance. Explain

Q Show how a monopsonist can drive down wages.

Q How did the models of Chamberlain and Robinson help pave the way for, and later give justification to, Keynesian economics? (hint — wage/price stickiness)

Q Why would product differentiation lead to overproduction of goods, according to Chamberlain?

Chapter 18: Mathematical Economics

Is $1 + 1 = 2$?

Is $2 * 2 = 7$?

If you answered yes and no, then you can skip the rest of this chapter

Chapter 19: Institutionalists

Why did it arise in America?

How was it an outgrowth of the German Historic School?

Major Tenants (and why...)

Holistic approach

Focus on institutions

Darwinian, Evolutionary (path dependency) approach

Rejected idea of equilibrium

Assumed clashing interests

Believed in Liberal, Democratic Reform

Rejected simple pleasure/pain utility, argued its more complicated

Veblen

Veblen Goods

Theory of the Leisure class

Conspicuous Consumption

Avoiding Useful Work

Conservatism

How does this impact society as a whole?

Problems with Neo-classical economics

No consumer sovereignty

Hedonism was too limiting of an assumption

Not rational economic calculators

Instinct for workmanship

Soviet of Technicians

Rule of engineers (technocrats)

Mitchel

NBER

Galbraith

The conventional wisdom and critique of economics

Large firms and the managerial economy

“created wants” vs. real wants

Overproduction

The managerial class and its interests

The Theory of the Firm

Ownership and control are divorced, so now a

Protective function, and a

Affirmative function

Policy implications

Monopolies don't maximize profits,

They maximize sales

Not enough public goods, too much private goods

Douglass North and New Institutionalism

Q Why did Galbraith believe that monopoly regulation was useless (hint: what did Galbraith think monopolies did, as opposed to what everybody else thinks they do)

Q Explain how Douglass North and the New institutional economists differed from the original institutionalists.

Q Why did Galbraith believe that private goods were being over-produced and over-consumed in the modern economy?

Q What is conspicuous consumption according to Veblen? Why are status goods, and the economics of status goods, NOT positive sum in the sense of Adam Smith?

Chapter 20 Welfare Economics

Pareto

Refinement of Edgeworth, and the Edgeworth box

Pareto Optimality

Moved away from GE of Walras, towards

Exchange instead of production
Be able to describe it, and its limitations

Pigou

Income redistribution: when can it be good
Society is biased away from savings (irrationality)
The problem with private and social costs
Externalities
Pareto optimal does not hold with 3rd party effects
The Pigovian tax to align public and private costs/benefits
Be able to model a Pigovian tax on a negative externality
Assumptions to make the tax work
Criticisms of assumptions by public choice economics

Mises and Hayek

The socialist calculation debate
A centrally planned economy and the problem of information
A centrally planned economy and the problem of incentives
Prices as information.
Dealing with change
The Entrepreneur in the economy
The central planner destroys the information he needs.....

Oscar Lange (Abba Lerner)

The central planner can do it.
A system of shadow prices, ratios of different values to capital
And if $P = MC$ and
 $MRTS =$ for all capital,
Efficiency.
Shortages/surpluses can be dealt with by the planner,
Through a trial and error adjustment of prices

The empirical evidence, and the final (?) end to the socialist calculation debate

Kenneth Arrow

Arrows impossibility theorem
Democracies produce “irrational” decisions.
Example: Multi-peaked preferences
Know the example of Condorcet (vote cycling) given in class

James Buchanan

Public choice economics
The benevolent despot – does he really exist?
The assumptions of Homo Economicus,
Are the same as for Homo Politicus
“loose the we”

Critiques of Pigovian taxes (given in class)
How to determine Q?
Does the hurt party actually get compensated?

do you really think a politician is maximizing Social welfare
or does he maximize his own utility?

~~Constitutional Economics~~

~~Three principles~~

~~Fair rules that cover process, not outcomes~~

~~Limitations on the game (rights)~~

~~Side deals to get the disaffected to agree...~~

Q. Model an externality, and use a Pigouvian tax to achieve the socially optimal quantity of the good.

Q. Why does this socially optimal amount neither solve the political problem associated with it, and it's a nonsense concept anyway, according to Buchanan. (Hint – what is the process we use to discover the socially optimal amount)

Q. Pareto optimality is a set, that can include in it some very unfair looking societies. Explain

Q. Pareto optimality assumes three things about the MRS, MRTS, and no externalities. Are they realistic?

Q. How does income redistribution fit into Pareto optimality?

~~Q. Constitutional economics is concerned with “the rules of the game”. It is about process, not outcomes. Explain~~

~~Q. Explain Buchanan and Rawles theories of “behind the veil of ignorance”.~~

~~Q. Explain Sen’s paradox of the Utility monster.~~

To be added... Chapter 21, 22, 24 Just did in class, so no separate reminder...

More Sample Questions

- Q. What did Marshall believe were the 4 factors that determined wages?
- Q. What is a Veblen good? Give an example from Thai Society
- Q. How did the early marginalists, and their focus on micro instead of macro, begin advancing economics again.
- Q. Why was marginal analysis necessary to get economics moving again?
- Q. How did marginalism finally disprove the Iron Law of Wages? Why did it also show that wages COULD BE below the sustenance level?
- Q. “the institutionalists were correct, institutions had different cultures and goals than simple firms in a Smithian economy, but they were wrong, in the belief that economics thus couldn’t explain the modern economy” Evaluate and explain this statement. (Hint – North and New Institutional Economics)
- Q. Why did Galbraith believe that anti-trust regulation was useless, and that indeed MORE large firms would lead to more competition?
- Q. Evaluate and Critique Galbraith’s view of why consumers don’t really want to consume all the goods they do, but instead would (should) prefer more public goods
- Q. Explain a Pigovian Tax. Explain how it brings private and social cost into alignment, and how this brings us into pareto optimality.
- Q. Explain why a Pigovian will tax will do no such thing (Buchanan’s critique of a Pigovian tax)
- Q. Explain why/how rational individuals can produce irrational vote outcomes (hint: Arrow)
- Q. How does vote cycling occur? Why does this mean that a skilled agenda setter can influence a vote outcome?
- Q. Explain both sides of the socialist calculation debate. Who won in the short term, and who won in the long term, and why.
- ~~Q. Explain Chamberlin’s model of monopolistic competition, and why it leads to higher prices and a lower quantity than pure competition, but less than would be the case in a true monopoly.~~
- ~~Q. Why did Chamberlin believe the economy as a whole could have excess capacity, and that firms would produce where $AC > MC$.~~
- ~~Q. Explain Joan Robinson’s view that Monopsonies (especially in the labor market) could lead to under utilization of resources, and productive factors not being used to produce.~~

Q. Explain Keynes's view of the role of "Animal Spirits" in the economy. Explain it both in terms of herd behavior, and in terms of long-range productivity forecasts.

Q. Explain Secular Stagnation in terms of Keynes's observation that MPC (the marginal propensity to consume) is $MPC < 1$. Why would this lead to unemployment? (hint: circular flow)

Q. Be able to explain the Keynes Cross.

Q. Be able to explain why Friedman thought it was mis-specified.

Q. What was Friedman's "permanent income hypothesis". How did it explain why secular stagnation didn't seem to happen.

Q. What was the Keynesian investment function, and how did it make investment so sensitive to future expectations.

Q. What caused the great depression according to Keynes, and what event got us out of it, and how?

Q. What caused the great depression according to Friedman, and what event got us out of it, and how?

Q. "The Philips curve finally allowed central bankers to steer the economy between Lerner's famous curbs, it and Keynesianism have turned economists from theoretical physicists into practical engineers". Explain and evaluate this statement.

Q. Explain the LR and SR Philips curve, and why the original curve was mis-specified.

Q. the Lucas Critique: "any empirical relationship discovered with econometrics will break down once the government begins to use it as the basis of policy". Explain

Q. What is vote cycling? Why is it a problem for economists.

Q. What is an agenda setter. How can they control or influence voting outcomes, and why is that important from the standpoint of economists.

Q. Quote "Economists spent the 20 years after WW II assuming a Benevolent Despot named G, who would solve the problems of market failure if only politicians would listen to economists. To judge between competing ways of organizing activity, the study of "market failure" must be paired with the study of "political failure". Explain the above, and use a contemporary Thai example to illustrate both market and government failure.

Q. Explain why "winner take all" elections produce two-party systems of politics, while proportional representation produces multi-party systems of politics. How will the two systems look different?

Q. What is the difference between a majority, and a plurality. What is a run-off election when an election does not produce a majority.

Q. Explain the median voter theorem. Be sure to know both the weak version and the strong version of it.

~~Q. What are some other vote systems discussed in class. (veto voting, weighted voting, run-offs, etc)~~

~~Q. Define Rent Seeking. Explain why it can be beneficial to some individuals, but is harmful to society as a whole.~~

~~Q. Explain the transitional gains trap, where the benefits of rent seeking go away, but the sub-optimal economic organization remains.~~

~~Q. Explain why the gains from rent seeking could all be competed away in a competitive rent seeking environment.~~

~~Q. Voting is irrational. Explain.~~

Q. Explain what expressive voting is, as opposed to instrumental voting.

~~Q. Racism is costly both to those who are discriminated against, and to those who do the discriminating. Using Becker's concept of a "taste for racism", explain this.~~

~~Q. Explain Becker on children as consumption goods, or as investment goods. Explain the search market for marriage, including why couples are more likely to divorce early as information sets expand, but sudden success can put a strain on marriages.~~

~~Q. Explain human capital formation, and the importance of both general and specific human capital.~~