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PRØVE

POL2012 1 Teorier og modeller i politisk økonomi

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1 Del 1

Del 1

Svar på **ALLE** de følgende spørsmålene (50%):

Spørsmål 1: Forklar Ricardo's teori om leie.

Spørsmål 2: Modeller og forklar en endring i etterspørsel.

Spørsmål 3: Anta at Italia kan produsere enten 120 tonn oliven eller 7000 liter rødvin, og at Hellas kan produsere enten 80 tonn oliven eller 2000 liter rødvin. Bruk Ricardo's teori om handel til å forklare potensiell handel mellom de to landene.

Spørsmål 4: Forklar Marx's teori om fallende profi

Spørsmål 5: Hva er de vanligste analyseenhetene i den neo-klassiske tradisjonen?

Spørsmål 6: Forklar hvorfor jordreform er et sentralt første steg innen økonomisk utvikling i følge Studwell (2013).

Spørsmål 7: I følge Bates (2008), hva er problemet med det han kaller 'kontrollregimer' ('control regimes')?

Skriv ditt svar her**Spørsmål 1:**

Ricardo's theory of rent shows how most of the surplus from a piece of land goes to the landowners in the form of rent.

He divides the surplus into three parts:

- The rent, the part of the surplus going to landowners. (Rent in this case is only the payment for the land, not houses or utilities as we usually associate it with).
- The profit, the part of the surplus going to the capitalists.
- The wages, the part of the surplus going to labor.

To explain the theory I will use the example of a farm. The theory rests on two key assumptions:

1. The quality of land differs. This can for example be the lands ability to grow crops, or in recent times, the lands location and proximity to other business etc.
2. There is competition between capitalists, so their profitability is the same.

In the example of farms, the landowners owns the land, the capitalist is the farmer and owns the equipment, and there are workers on the farm. The landowner raises the rent, taking most of the profit of the farmer. The farmer then lowers his workers' wages. As more and more land is cultivated, and more and more farms appear in the area, farmers' profits are reduced because of lower produce prices. The farmer lowers the workers' wages until they are at sustenance level (the lowest they can go while still being able to work for the farmer). As profit is reduced, a higher and higher percentage of the land surplus goes to the landowner. This happens across the system, until all land is cultivated and the landowners take all of the farmers' profits. Wages will be at sustenance level.

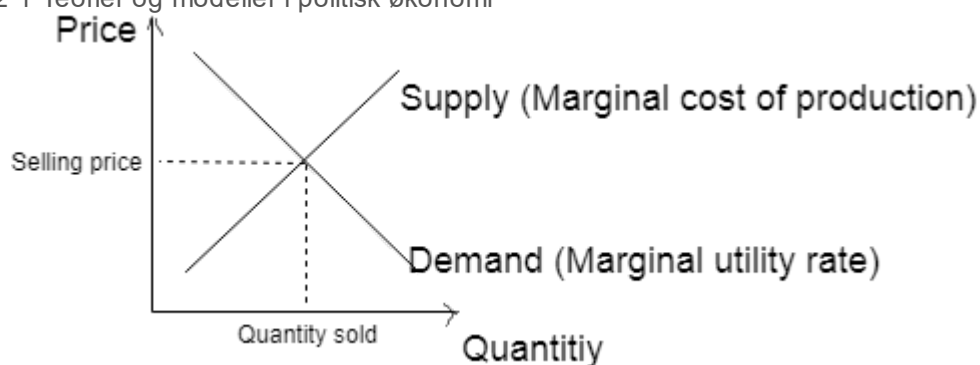
Spørsmål 2:

I assume the question refers to neoclassical economics, and I will use a neoclassical model of supply and demand.

This model is created from the following (long list of slightly unrealistic) assumptions:

- The market is a free competition market, as there is a large number of both buyers/consumers and sellers/producers. Everybody have to take the price for granted, and no one firm have enough market power to affect it.
- The product is unique and have no substitutions.
- Both consumers and producers have full information about prices, alternatives and the market. E.g. firms can't make consumers buy their product for more money if there are a cheaper alternative.
- Consumers demand are modeled from their marginal utility rate of the product (the utility they get from having one more of the product). This curve slopes downward because of the assumption that, the more you have of a product, the less utility you get from one more. Therefore, the price have to be cheaper for you to buy more of it.
- Producers supply are modeled after their marginal cost (the cost of producing one more product). This curve slopes upwards because of the assumption that, as you produce more and more, producing one more of the product is more expensive (in the short run). E.g. when you have 1 worker working on 1 machine, and hire 1 more, you can produce almost twice as much (depending on production methods), but if you have 100 workers on 1 machine and hire 1 more, you will produce almost nothing more or even less. All products are also sold at the marginal cost of production because of competition driving the price down.

This is the state of the market before the change in demand (forgive inaccuracies in the drawing):



This is an illustration of the change in demand:



There is a fall in demand, and you can see that both the new quantity and new price are lower than before. This change in demand can for example come from a reduction of income for the population, or new information about the product, such as the revelation of a polluting production method or similar, making it less desirable.

Spørsmål 3:

Ricardo was an advocate of free trade, and his theory of comparative advantage uses opportunity costs to explain why countries trade, even when one of the countries have absolute advantage (it costs less) producing all of the goods they trade with. It is assumed that labor and capital can't move between countries.

In this case Italy produces 120 tonnes of olives or 7000 liters of red wine, and Greece produces 80 tonnes of olives or 2000 liters of red wine, in a given amount of hours of work. We can see that Italy have absolute advantage in producing both goods, but can both countries be better off if they trade?

Country\good	Olives (tonnes)	Red wine (liters)
Italy	120	7000
Greece	80	2000

For Italy, the opportunity cost of producing 1 ton of olives is about 58,66 liters of red wine.

For Greece, the opportunity cost of producing 1 ton of olives is about 25 liters of red wine.

This means that Greece have the comparative advantage in producing olives.

If Greece only produces olives, and Italy only produces red wine, both countries can be better off if they trade 1 ton olive for anything between 25 and 58,66 liters of red wine. If Italy wanted olives and produced it themselves, they would "pay" ca. 60 liters of red wine per ton of olives (in opportunity cost). But instead, they could get the same amount of olives from Greece for possibly as low as 25 liters of red wine (if they have good negotiators). In Greece' case, they get more wine than they could possible make per ton of olive produced. Both countries are better off.

Spørsmål 4:

Marx' theory of falling rate of profits are one of his arguments for why capitalism is doomed to repeated and worsening crises. The theory states that as firms expand and grow, their profit rate is falling. This is because of the rate of capital input per worker. As firms expand they use more machinery and better equipment to produce their goods, and less and less labor is needed. If your competitor buys a new, productive machine, you are almost obligated to do the same if you want to keep your business. This lowers the cost of production, and hence the price. As Marx' labor theory of value states, the value of a good depends on the amount of labor needed to make it (and the quality of that labor, such as ability and education etc.). The price of labor power (wages) is established in the labor markets, while the price of the good (which is usually a lot higher than the price of labor power, leading to exploitation) is established from the actual labor put into it. The reserve army of labor ensures that wages are kept at a minimum, as there will always be someone willing to work for minimum wage.

Spørsmål 5:

The most normal units of analysis in neoclassical economics are individuals and firms, and their marginal values, such as marginal rate of utility and marginal cost. This is respectively the utility you get from having one more of a good, and the cost of producing one more of the good. Neoclassical economics are also very concerned with the related equilibrium analysis, and the notion that markets will self balance because of supply and demand. This draws on classical economics, and Adam Smith's "invisible hand". This is related to the assumptions in question 2.

Spørsmål 6:

Studwell's book "How Asia Works" falls into the tradition of evolutionary economics. He takes a historical approach in explaining how many Asian countries managed to develop their economy and improve living conditions. He advertises a three-step approach, with the first being a rural farming reform.

Generally, this first step is to divide farming land into smaller patches so that each household have their own farm/piece of land. It was earlier common that rich landowners owned huge pieces of land, and exploited their workers. By giving each household their own piece of land, you lay the basis for the next step in Studwell's plan. Every household have control over their own land and gets the surplus that it provides. It therefore encourages them to be productive and develop their household. To do this, they will need tools, inventory and perhaps some nice furniture for their home etc. Each household therefore have: 1. an income, 2. the need to spend it. A problem here is that a land reform is hard to implement. Some ways countries have done this is through violent power, or buying up land and distributing it, perhaps as a (forced) loan.

The second step is to develop industry, and get it exporting. As households now have a (higher) income, developing the industry is easier. The key is to get the industry to export as soon as possible. I will not expand on this as it is not part of the question.

The third step is financial policy to support the two first steps. This may involve keeping a short financial leash with banks and other financial institutions, for example in relation to the land reform. Banks reasonably want to give loans to large farms with huge pieces of land, as they are more likely to return huge shares of profit, but the government can regulate this, and e.g. make the banks support the small household farmers (with loans). This also relates to developing the industry. Strict financial regulations will keep financial institutions in line with the government goals.

All in all, Studwell shows how a large amount of government involvement in the economy develops it over time. This is characteristic of evolutionary economics, and goes against neoclassical and neoliberal arguments that the government should have minimal involvement.

Spørsmål 7:

Bates is also in line with evolutionary economics, and he uses a game theoretic approach in explaining political (dis)order.

According to Bates, state leaders can either: 1. provide protection for its citizens, giving them the security needed to work and gain a taxable income, or 2. predate on its citizens, securing a large profit for themselves, but driving the country into political disorder, with the citizens taking up arms.

The governments actions depend on the time horizon. If there is little political risk, state leaders may assume that they will be sitting in government for a long time period. They will then reap the benefits of a working population, earning tax incomes that provide their salary for sitting in office. They will choose this because it is a secure income over a long time period.

If there is a lot of political risk, e.g. if the US states that they will stop backing your country in two years, the state may predate on its citizens, perhaps in the form of control regimes, or seizing natural resource mines etc. by force. The state leaders earn a much larger income than just the populations taxes, but for a shorter time period. Generally, the people get unhappy and take up arms, leading to political disorder and a failed state. Of course this just increases the political risk, leading to more predation etc.

Besvart.

2 Del 2

Svar på 1 av følgende spørsmål (50%):

Spørsmål 1: Forklar enten den vellykkede økonomiske utviklingen eller mislykkede økonomiske utviklingen i et valgfritt land, fra et 'evolutionary economics'-perspektiv.

Spørsmål 2: Velg et relevant teoretisk perspektiv å diskutere problemet med økonomisk ulikhet, samt mulige botemidler.

Spørsmål 3: Diskuter den globale finanskrisen (2008-2009) i lys av en statsgjeldkrise, slik tilfellet var for Hellas og Island.

Skriv ditt svar her**Spørsmål 2:**

I will in this question use the theoretical perspective of Marxism to discuss the problem of economic inequality. I will be using only this one, as the questions states to choose only one (although I allow myself to make some comparisons with tangent explanations from Keynesian economics). A lot of economic perspectives naturally discuss poverty and inequality, but I chose Marxism as it is particularly relevant to the issue. Marx analyses class divisions in society, and the normative sides of his theories are easy to see and acknowledge. This is natural, concerning his combination of economic theorizing and call for political action or even revolution.

First, I will talk about the labor theory of value, exploitation and the reserve army of labor, while showing how these concepts lead to poverty and economic inequality according to Marx. After that I will discuss how this leads to economic crises, showing how the problems of inequality not only affect the working class, but the whole economy. Lastly, Marx' suggested remedy of socialism is discussed, with a part about paralleling suggested remedies from other economic perspectives.

The labor theory of value and exploitation

Some of Marx criticism of capitalism is his labor theory of value and how it relates to exploitation. Marx built on the classical labor theory of value. The value of a good comes from the labor needed to make that good. This is logical if you imagine that if a chair needs one hour of labor to make, and a table needs two, a table is twice as expensive as a chair. Machines and equipment used in the making of the chair and table, also comes from labor. All value can be traced back to labor. In addition to this, the value of a good would rise and fall according to supply and demand, but in average it would cycle around its "natural price".

Marx focused on the 'labor' part of this theory. He developed it further. Not only the hours used to make a good applied, but also the quality of that labor. A chair specialist could perhaps make a chair in only 20 minutes, but if it is exactly the same as other chairs, it would sell for the same as a chair made in one hour. Education, productivity and other things change the quality of the labor. A second and important change to the theory done by Marx is the description of exploitation. There is a difference between labor potential/ability and actual labor. When wages are set in the labor market (by supply and demand of labor), what is determined is the price of labor potential. Consider the case of the chair specialist. He is applying for a job at the chair making factory, with an ability to make 3 chairs an hour. Since he is qualified, he gets the job. However, his wage is determined by supply and demand of labor. His wage are as low as the lowest any unemployed laborer is willing to work for. His bosses, the capitalist owners of the chair factory, pays him only this low wage, while the rest of the actual value of the labor (the price of the chair), goes to them. This is the exploitation part of Marx theory. Laborers see only a fraction of the money produced by their labor, as capitalists extract most of the surplus. Two classes are forming, the poor working class, and the rich capitalist class.

An important part of this is what Marx call the reserve army of labor. This is all unemployed workers willing to work at minimum wage. Since the factory owners can fire you at any time and hire someone willing to work for minimum wage, wages are kept at the minimum level possible for economic and social reproduction (the workers need enough money to live, and produce more workers for the capitalists to exploit). In Marx times, these workers came from rural societies that found their labor unnecessary, in light of efficiency improvements. They came to cities and factories in large numbers looking for work. In modern times, the reserve army consists of recent additions to the workforce, such as women (not at all a bad thing, but something that adds to the reserve army of labor according to the theory of Marx), immigrants,

and young people. A common theme in these groups of people are having part time jobs. In Norway, the female dominated occupation of nurses are commonly hired part time only. There are stories in media about nurses needing two or three jobs to survive. These conditions keeps the reserve army of labor very much living, although nurses are generally hired by the state, that have the interest of the people in mind, and not profit.

Economic crises

Exploitation is not only bad for the individual, but for the whole of society. According to Marx, it does not only keep wages at minimum level, but it is also one of the reasons that capitalism will continue to have more and more economic crises of ever increasing severity. Marx gives three reasons for this. One of them is directly related to inequality. It is relevant to note here, that Marx assumes that economic growth is the same as capital accumulation.

Firstly, you have the problem of disproportionality. The capitalist system have a lack of central planning. Capitalists and firms have no way to 'know' what is always needed and what price it should be sold for. Yes, classical economists (which Marx based his theories on), such as Adam Smith theorized that the market would sort itself out with the help of "the invisible hand", but Marx meant that it was vulnerable to external shocks. Let me illustrate with an example. If you are a car factory, and the price of oil suddenly rises (e.g. as a result of an OPEC decision to limit oil production). Fuel will be more expensive, and the demand for cars will sink. It will also be more expensive to buy supplies such as steel because of transportation costs. You suddenly have an excess of cars produced because you anticipated higher demand, and you have to lay off some of your workers. The steel factory also lay off people, because the demand for steel lowers. The steel making equipment factory also lays off people, and so forth. The whole economy experiences the shock. In addition, the laid off workers have no wage, and aggregate demand in the economy sinks. This makes a never ending spiral.

Secondly, you have the problem of the falling rate of profit, as described in question 4 in the first part. In short, as businesses expand their rate of profit sinks. This is not compatible with long term economic growth. At some point the growth will stop. Capitalists will assumable be discouraged from continuing business activity with a lot lower profit rate than earlier.

Lastly, you have the problem of underconsumption. This relates directly to inequality stemming from low wages and exploitation. A problem with the capitalist economic system was that the majority of people was poor. Yes it was a problem for individual poor household, but also for the system as a whole. In order to extract surplus value, capitalists have to create it (produce goods using cheap labor), but also realize it (sell those goods). That's where underconsumption comes in. As the reserve army of labor keeps wages low, there will be a lack of demand in the economy. Wages are kept at sustenance, and the workers buy only that; sustenance, and nothing else. This leads to a problem of realizing surplus value, and economic crises are abound.

Potential remedies

Although Marx' suggested solution was a violent socialist revolution, his theories give us insight into why other economic perspectives suggest the remedies that they do.

As stated, Marx suggested a violent socialist revolution at first. However, even he himself realized that change might come from within the system itself through reform. Marx did little to specify how a socialist system would be in practice, but there are some characteristics we can assume that it would have, as well as upsides to implementing such a system. I am here discussing a little bit outside what Marx specifically discussed. One of the first upsides that comes to mind is the case of a central planning entity. Although neoclassical economics

suggests this would need an almost god-like availability of information and lead to an inefficient system, the upsides are there. It would take care of the disproportionality problem, as well as distributional problems leading to inequalities. If all factories are state-owned, with the state planning most or all economic exchanges, poverty could be eradicated, as long as the capacity to produce a base level of goods remained. We would have economic equality, social equality and equality in opportunity. There have been many arguments against such a system throughout history, but the upsides are clear. Such a system could also put every able worker in jobs, which could potentially lead to higher living standards, and eliminate the reserve army of labor. Perhaps the most clear upside is the elimination of capitalists. With state owned factories and firms, there are no capitalists to extract the fruits of your labor, and the state gives you your fair share of surplus value created. This 'wage' would arguably be higher than in a capitalist economy.

I will argue that this generally would be in line with what Marx suggested as remedies. But as stated, arguments against this system are plenty. One remedy that are tangent to this solution is what we find in modern social democratic countries such as Norway. Such countries have in large part based their policies on neoclassical and keynesian perspectives. Keynes based his work on neoclassical theory, but tried to take a middle road between government intervention and free markets. His macroeconomic theory are not so relevant to this discussion, other than in how to prevent/fix economic downturns, but many social democratic countries use redistributive, progressive tax rates as a means to increase economic equality. In Norway, this is supplemented by the states involvement in wage negotiation. The state invites business and labor unions into negotiations to find a fair wage, oftentimes based on Keynesian macroeconomics suggesting wages should be on par with consumer price increases. I hope I am not discussing other economic perspectives too much, but the case of wage negotiation is relevant to Marxian economics. It is all made possible by the large amount of unionized workers, something that Marx most certainly would have applauded. Their combined negotiation forces lets them earn their fair share of the economic surplus created by their labor. Perhaps is this more in line with what Marx wanted with socialism, or perhaps socialism would make way for even more economic equality, it is hard to say. One could say that higher wages also hindered economic growth according to Marx, because it prevented capital accumulation. In that case, socialism could be the only real alternative.

Conclusion

I discussed how inequality of classes are created according to Marx, and then I showed how he argued that it would lead to ever increasing economic crises. I then discussed Marx suggested remedy of socialism, and how it relates to social democratic progressive taxes and wage negotiations.

In conclusion, Marx was certainly concerned with economic equality between the classes, and a lot of his work relates to it. These ideas continue to be relevant today, such as described in the case of the reserve army of labor.

Besvart.