



KANDIDAT

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PRØVE

# POL2012 1 Teorier og modeller i politisk økonomi

Emnekode	POL2012
Vurderingsform	Skriftlig eksamen
Starttid	29.11.2021 09:00
Sluttid	29.11.2021 13:00
Sensurfrist	20.12.2021 23:59
PDF opprettet	30.11.2021 19:46
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**i POL2012 høst 2021****Institutt for sosiologi og statsvitenskap****POL 2012: Teorier og modeller i politisk økonomi**

*Dato 29.11.2021*

*Eksamenstid: 09:00-13:00*

Tillatte hjelpemidler: Ingen

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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**

1:

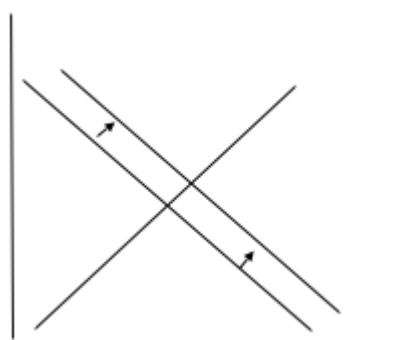
Ricardo's theory of rent is a theory that tries to determine the effect of rent on the economy as a whole. the theory focuses on the effects of ownership of agricultural land. Ricardo argues that the land-owner class stands against both the workers and the capitalist. This is because the land-owners do not bring any productive activity to the system, and derives income solely from the fact that they own land. Because land is a scarce resource, they can force capitalists to pay part of their profits as compensation for their land, and if they notice that the profits increase due to more efficient farming, they can again seek to increase the prices for land. For the workers, it is not ideal either. With decreased profits there is less headroom to negotiate higher salaries. The nature of how capitalists can increase profits, means that it is often the workers that are affected the hardest from an increase in land prices. (either because this means lower salaries, or because it means more work, or harder work)

With protection from out of country agricultural products, and the nature of the British geography (not that much fertile land), the land owners can seek extortionary prices for their land. This is one of the reasons that Ricardo argues for a repeal of the Corn Laws in Britain, as well as arguing for decreased, or zero tariffs from overseas (continental Europe). This will increase competition in agriculture, causing the land-rent prices to decrease. This makes it so that the landowners cannot exploit workers and capitalists to the same degree.

One can see how the effect of this is present in Studwells book of economic development in Asia, where land was distributed equally amongst farmers in Korea, Taiwan and Japan (somewhat the case for China as well). The increased profits that small scale farmers got, were put to good use in the economies, giving them increased means for consumption, without a landowner class taking parts of the profit. This allowed for rapid economic development.

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The graph over depicts a change in the demand of a good. The graph is shifted upwards, meaning that the change is an increase in demand, giving a higher willingness to pay for the good. This means that the demand-supply equilibrium will have changed to a higher price and a higher quantity. Because of the increased willingness to pay from the consumers, the quantity that firms are willing to supply also increased because there will be a new point where the marginal cost will equal the marginal willingness to pay.

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3:

	Italy	Greece
Olives	120	80
Red wine	7000	2000

Ricardo's theory of comparative advantage argues that trade between nations will always be advantageous for both nations due to the ability to specialize on the products that the country are most efficient at producing comparatively, and the ability to trade with the another nation for the products that one is less efficient at producing. his will lead to the most amount of each good produced.

This was both a theoretical argument Ricardo could solve with maths, but also something he saw in the real world.

The theoretical argument goes as follows (using the example in the question:

Italy has the absolute advantage in producing both red wine (7000 to 2000) and olives (120 to 80) if both produces only that ware. Using previous thought one might argue that it is best for Greece to protect each of these industries so that it can compete with the Italian. However Ricardo finds that the most efficient outcome is found when each country focus on the ware that they comparatively are better at. For Italy this will be Red wine ( $7/2$  for red wine,  $3/2$  for olives) and for Greece this will be Olives ( $2/3$  vs  $2/7$ ).

A perfectly split production, without trade would yield 100 tons of olives and 4500 liters of red wine. A trade with total specialization would yield 80 tons of olives and 7000 litres of red wine. Even if Italy splits 25 % of its production to olives the outcome would be better for both goods (110 tons of olives and 5250 litres of red wine). The last examples gives a total production that are greater on both goods compared to the first example without trade.

The theory of comparative advantage does not account for the effects specialization will have on the output of the wares. This will lead to even greater returns on trade, as with specialization into one ware, the output tend to increase due to workers getting more productive over time.

The theory does not account for the demand of each good on the market, and in modern neoclassical economy, it might be more useful to use equilibrium theory, and theory of supply and demand to see if there is a need at all to produce. The demand for olives might be higher than anticipated meaning it might be good for Italy to shift some of its production from Red wine to olives

4:

Marx's law of profitability determines that in a capitalist society, firms profits are bound to fall over time. This is because of the expansionary and competitive nature of capitalism. For capitalism as a system to work, there has to be an ever expanding economy. The profits are used to buy more capital to produce more profits. However, with each additional capital machinery, and each additional worker to man it, the productivity falls, also affecting the bottom line of the capitalist. Over time, this happens to the economy as a whole, and at a point the economy stagnates because of there not being room to grow. This can lead to an economic crisis.

This is one of the laws, together with the tendency for underconsumption, that Marx argues are the reason that capitalist societies tend towards economic crises.

The solution for Marx is that at one point there will be an economic crisis so big that the workers will unite and overthrow the capitalists, creating a more stable socialist society. This prediction turned out false.

In later times, other economic theory has explained the tendency towards economic crisis better than this theory by Marx. Ex. Keynesian theory of aggregate demand and cycles, as well as Minsky's theory of economic crisis determining that a period of over-optimism will lead to a Minsky-moment where people will see that the economy is not as well off as one thought.

5:

The unit of analysis in neoclassical political economics tend to be microeconomics - determining how individuals and firms should act individually. This is extrapolated to also be true on the macro scale (for the whole economy).

Assumptions in neoclassical economics:

- Utility (actors basing their decisions on the utility of them)
- Rational actors
- Perfect information
- Competition

What is great about the neoclassical tradition is that it, in the cases where its assumptions hold true, there is a simplicity to what needs to be done to create

The extrapolation of microeconomics to macroeconomic has been subject of criticism, and where it is argued that assumptions that can be made on a small scale, doesn't always work on a large scale, where there are a lot more factors involved. Neoclassical economics is criticized for hiding behind market failures and externalities in cases where the theory cannot explain the phenomena that happens in the real world. Institutional economics for example, looks at the role of institutions in the well being of economics. This is dismissed by neoclassical economics as simply an externality.

Neoclassical economics is deductive in nature - meaning it looks at theory first, then determines if this holds in the real world, this is a shift from the classical tradition, that tended to be inductive, looking at real world first and seeing what could be explained from the findings.

6:

Studwell argues that land reform is essential for jump starting industrialization. Land reform, in this case, will mean that agricultural land will be distributed equally (based on yield possibilities), in small units, amongst the farming population (giving each family their own plot of land to farm). This will move the ownership of land, from a select few land owners, to the workers actually working the land, increasing the profits, by not needing to pay rent on the land that they use. The second, equally important, effect of this is that smaller units of land will increase the overall yield per sq/m. This is a general trend in farming. When workers have a smaller unit of land to be responsible for the yield of that land will increase. While the yield per worker, might be lower, this is not a concern in an economy where there is too much unskilled labor, and this labor is very cheap. Then it is better to use all the labor one has available, than too have a more efficient yield per worker. When industrialization has begun, one can start to move towards a more efficient, less workforce agricultural production. A third effect of such a land reform is that it is as close as one can get to perfect competition, where each farmer has the same possibilities for production and profits, leading to everybody needing to find new solutions to get an advantage over other farmers. This greatly increased the yield.

The reason this is important is twofold. The first is that increases in yield leads to richer farmers on average. This allows for increased consumption amongst the population, and allows for a new market that domestic industries can sell to. If farmers were poorer this would not be a possibility.

The second reason, maybe even more important factor, is that the increased profits from farming could be and should be used to buy capital for start infant industries - which is Studwells second part of jumpstarting industrialization and developing poorer economies. A land reform will provide the basis for getting money to buy capital equipment, and without it there is no possibility for the country to industrialize. As Reinert and Schumpeter found, there is little possibility for economic development if there has not been an industrialization in the country.

This reform was enacted in Japan (twice), then later in Korea and Taiwan, as well as in China (although farmers only rented the plot here). This increased their yields dramatically (30-50%). The implementation in the different countries were a bit different and the political implications of the reforms likewise. In the cases of Japan, Korea and Taiwan, it was pressure from communist forces (as well as pressure from Americans to counteract the communist forces) that forced them to enact the reforms. Teachings from the Chinese revolution found that land reform was an effective measure to get the peasant population on your side. This was one of the main tactics that the Chinese communists used to take villages over peacefully.

7:

Bates argues that control regimes are one of the reasons that economic and political developments in Africa has not happened as it has happened in other regions in the world, leading to instability both economically and politically in the region.

Control regimes can be described as regimes that depend on local support to maintain the stability in the area of the country. In many African countries, village elders and other influential people have influence that can sway support towards a leader. In infant democracies the institutions of democracy that exist in western democracies are not in place. Village elders instead control a lot of sway in what people vote and who they support. It is important for the state leaders to keep these in check. Therefore they are willing to give favors, use part of the fiscal budget to keep their support. This can often lead to the incumbent and the competitor to compete with increasing offers of favor to keep the support of the elders. This makes democracy very expensive in Africa, and undermines the development of the countries, as the money used to buy favors could most definitely be used in a more efficient manner.

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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 statsgjeldskrise, slik tilfellet var for Hellas og Island.



**Skriv ditt svar her**

1:

**The case of Chinese economic development in an evolutionary economics perspective**

Chinese economic development has often been said to be unprecedented. In the last three decades, China has maintained a growth rate of over 10% per annum, and allowed them from going from a mostly agrarian society to now becoming an industrial powerhouse, soon equaling the status of the US. The economic growth has had an impact on the individual as well, increasing the living standards and the opportunities for Chinese citizens dramatically. It is important to understand how this has happened, and what other countries can learn from the development so that they as well can develop in the same way. Studwells book (2013) provides an evolutionary economic perspective of how the development happened, and I will use this book extensively in the essay below.

**Evolutionary economics**

The evolutionary economic perspective differs from neoclassical economics one some important points. The evolutionary perspective weights the history of the economy, or how the economy developed to become what it is to a greater degree than the neoclassical tradition, that is mostly ahistorical and only concerns itself with the economy at the present. Furthermore the evolutionary perspective uses a bounded rationality approach rather than the prefect rationality assumption that one finds in the neoclassical tradition. This means that while actors try to act rationally, this is limited by factors of cognitive limitations, time constraints and imperfect information, and actors end ut trying to find satisfying solution rather than the perfect solution (satisficing). This is important to show how and why decisions are being made.

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If time

Creative destruction

Reinert

**First stage - Land reform**

Studwell argues that there are three main steps in developing into an industrial economy. The first is is land reform. Land reform, in this case, will mean that agricultural land will be distributed equally (based on yield possibilities), in small units, amongst the farming population (giving each family their own plot of land to farm). This will move the ownership of land, from a select few land owners, to the workers actually working the land, increasing the profits, by not needing to pay rent on the land that they use. The second, equally important, effect of this is that smaller units of land will increase the overall yield per sq/m. This is a general trend in farming. When workers have a smaller unit of land to be responsible for the yield of that land will increase. While the yield per worker, might be lower, this is not a concern in an economy where there is too much unskilled labor, and this labor is very cheap. Then it is better to use all the labor one has available, than too have a more efficient yield per worker. When industrialization has begun, one can start to move towards a more efficient, less workforce agricultural production. A third effect of such a land reform is that it is as close as one can get to perfect competition, where each farmer has the same possibilities for production and profits, leading to everybody needing to find new solutions to get an advantage over other farmers. This greatly increased the yield. (Copied from part 1)

In Chinas case this reform was enacted twice. The first time this was enacted was in during the Chinese Civil war in the after war times when Chinese communists used land reform as a way of increasing support amongst the peasant population, and was not a economic reform

per se. While there is limited empirical evidence from this time, some sources estimates that the land reforms also this time increased the yields in the country. It can also be seen from the devastation that came when the Mao-government reformed the agriculture sector again, this time collectivizing the farms. The great leap forwards led to mass famine in the countryside and backpedaled a lot of the progress seen in the beginning of the Maoist reign. When Mao died, Deng Xiaoping, the new leader of China, reformed the agricultural sector yet again, this time decreasing the units yet again. However, the government still owned the land, issuing 15 year leases for the plots instead. This was an accidental policy, and were not meant to increase the yields the way it did. This didn't hinder the development and the first step of development was under way.

This first step of development can be said to be backed by both the evolutionary and the neoclassical tradition. The policy provides the perfect conditions for competition between small actors, which is also the perfect conditions for competition. However, the neoclassical tradition (and the political traditions that are inspired by neoclassical economics), stresses the importance of property rights as a factor that ensures stable investments. This detracts from land reforms as this is by definition expropriation of property for the case of redistributing it. However, it can be claimed that once the land reform is done, there is protection of property. The 15 year leases provide security for farmers to know that investments they do onto their plots will not be wasted.

### **Second stage - Industrial protection**

The second stage of development in the eyes of Studwell is the development of manufacturing industry. Manufacturing provides a way for an agricultural population to become industrial workers without much learning, as operation of menial machinery tasks does not have as steep learning curve as the development of higher technological industries and services do. A second factor is that manufacturing requires relatively cheap equipment to operate, and it is possible to buy second grade and secondhand equipment from further developed countries, rather than developing ones own manufacturing solutions. This means that the capital needed for starting manufacturing industries are less than that of other industries. Studwell makes a point about the importance of protecting infant industries. This is crucial for making sure that the industry can compete with rivaling industries in more industrialized countries. His first step is that in this infant stage, the state should be the owners of the industries. The state is not motivated by profits and has other revenue sources than the ones of the production in the firm. Therefore the state is able to take the loss in the starting phase of industrializing. Once the industries are able to compete with other countries, the state should leave the companies into the hand of willing entrepreneurs, who will compete with each other and come up with efficient solutions that will make the industries even more competitive. Because these countries are still not as developed as western countries they will also be able to use their cheap workforce to gain a competitive edge over these countries. In addition to this they can start opening up the economy to foreign businesses slowly with the intention of exporting more than they import. This has been the case of Chinese industry since its beginning.

China was especially good at the second stage of economic development. Because of the sheer size of the country, it had a larger economic chest to jump start its industrialization. While being quite cut off from the rest of the world, it did enact its policy of Free Economic Zones where foreign investment could thrive and help build industry, while keeping much of the risk of an open economy away from the average Chinese citizen. In addition because of China being such a large economy, there was extra willingness for western countries to allow them to enact their different protectionist policies, that other SEA countries could not afford to gain investment from IMF and WB. One point that makes the Chinese industry unique also in terms of the four success stories in Studwells book is that their industry was fully nationalized. However they circumvented most of these inefficiencies by having multiple state firms in each sector competing with each other to find good solutions. This allowed for a competitive environment even without a proper free market.

Studwell stresses the importance of the state in culling bad businesses. This was often done through export discipline, and was especially prominent in Japan, Korea and Taiwan, but also in China. This meant that businesses that were especially good at exporting their products to foreign countries gained advantages over other companies. They got export subsidies and special tax breaks. Because the domestic market is not as big as in more developed countries, exporting their wares to other countries is an important to gain access to larger markets. This is in opposition of much of neoclassical theory, which determines that the market should not be interfered with in this way. In reality it creates even harsher conditions than the market, and can be said to promote growth and efficiency to an even greater respect as there is additional advantages to be good at exporting. Additionally it breaks the rules of WTO. The second stage of development has therefore become increasingly difficult to enact, as one will be an outcast in the international system if one tries. China, due to its size, is one of the only countries that had and has the political and economic power to oppose this order. Japan, Korea and Taiwan underwent industrialization before these institutions were as big as they are at the present.

### **Third stage - Control of the financial sector.**

The third stage of development concerns controlling the financial sector in a way that benefits the development of both the agricultural sector and the industrial sector, and happens simultaneously with the other two stages. In respect to the first stage, it means controlling the financial aspect of agriculture. It is important to enact policies that allows banks to offer beneficial loans to farmers who needs capital to buy new equipment when they want to scale their production. In respect to the second stage it is important for the state to control and allow for investments into the specific industries the state wants to specialize in. Taiwan wanted to invest in microchips and Korea into memory chips. This impact is seen even today, many decades after the first investments, where each of these countries are leading in their respective field. This could not be done without the state controlling the financial sector.

This part is in strict opposition to neoclassical economics and shows the differences between the evolutionary economic perspectives willingness to regulate the market as to prefer the quality of good. This ties into Schumpeters (and Reinerts extension) theory that determines that also the quality of good is important for the development of countries, as a focus on lower quality goods does not give the same possibility for profits, because of ease of competition. Becoming world leading in certain industries is therefore crucial for the third stage of development. The term of creative destruction brings another dimension into the role of the state. Creative destruction describes a process in which innovation and new technologies are main ways for development to happen. This causes businesses to fall behind if they don't adapt and gives innovative businesses an edge. As previously seen, there was an extensive culling of bad businesses. This can tie closely into the tendency for businesses to dislike innovation, because it leads to expensive switches of capital. By culling bad businesses, the state forces creative destruction to happen more rapidly, in case their firm becomes the next to be culled. This encourages innovation, and is important for countries to develop into rich countries.

### **China - A special case?**

Oftentimes it is argued that the unprecedented growth of China can only happen in China. However, this notion is false. As seen in the cases of Japan, Korea and Taiwan, that enacted many of the same policies, the outcome is the same. These North-East Asian countries do however have some things in common that allowed the adoption of these policies. One commonality is the role of the state in the economy. They had a strong state, and were able to build strong institutions that built on the single motive of economic growth.

The one uniqueness of China is its size. Being one seventh of the worlds population, the staggering growth of 10 % per year over 30 years, is almost unbelievable. It also makes it seem like it will not be possible for other nations to achieve. However the cases of Korea and

Taiwan show that also smaller countries are able to grow given the right policies and circumstances.

**What went wrong in other countries**

There is one example of another country that was able to achieve the same number of growth as the four talked about above. This was Brazil. However, Brazils growth was almost solely based on a fiscal deficit, giving them enormous debt. This caused an eventual stagnation and regression for the country. Why were no other country able to achieve the growth numbers?

Inequality in land ownership was one important factor that decided the fate of many countries economic development. Brazil, as exemplified above, had one of the most unequal land ownership distributions in the world. This caused the yields be lower than necessary and eventually slow economic progress. Even western nations tend to have a more equal distribution than that found in many Latin American and SEA countries.

The one point, that might be the single most important, is that they listened to to bad advice from ideologically driven western countries and institutions. Here, free market interaction and enabling foreign investment was the two main points that one should open up for to enable economic growth. This included a strong financial deregulation to give banks and businesses more power for themselves to grow. In Thailand and other SEA countries this policy backfired. Banks gained to much power, and the interest of banks don't tend to align with that of the state or individual. Banks were more interested with keeping people indebted so they could get a steady stream of money, while not securing more risky investments for entrepreneurs.

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Besvart.