Possible History of Economic Thoughts & their answers

1. Describe Smith’s thoughts on sympathy and the Invisible hand.

Smith believes that man is motivated by self-interest, moderated by the recognition of (or “sympathy" for) the interests of others. The sympathy represents the ability to share the feelings of other members of society. This attitude leads us to judge our actions on the basis of their effects on others in addition to their effects on ourselves.

This kind of moral attitude is a prerequisite for the very survival of human societies. The idea that among the interests of each there is the desire to be loved by the others (and hence respect for the well-being of the others) is the pre-condition to ensure that the pursuit of self-interest on the part of a multitude of economic agents in competition among themselves leads to the well-being of society. (This is the essence for Smith’s notion of the Invisible hand)

1. Describe Ricardo’s falling rate of profits.

What happens to the rate of profits (π=k) in agriculture?

When only land No.1 is cultivated, the profit is equal to the surplus of the land 1, that is, 50 tons of corn (see Stage 1 table). When also land No.2 is cultivated, the profits on land No.1 shrinks to 40 tons, because 10 tons are now paid for the rent of land 1. Also the profits on land No.2 is equal to 40 (no rent is paid on this land; see table (Stage 2). Finally, when even land No.3 is brought into cultivation, the profits on land No.1 shrinks further to 30 tons. Also the profits on land No.2 declines to 30. And the profits of land No.3, on which no rent is paid, is also equal to 30 tons (Stage 3).

Ricardo's model implies that, as less fertile land is brought into cultivation, the profits in agriculture drop. Since in each land are employed the same quantities of workers and capital, also the profits rate (π/k) drops (see tables Stage 1, Stage 2, Stage 3). Ricardo also argues that the increase of rents and the decline of the profits in agriculture signals that the general rate of profit in the economy is decreasing.   
This conclusion is the result of the idea, introduced by Smith, that when capitalists are free to move their capital from one investment to another, the return on the funds invested in the different sectors - the rate of profits - must exhibit the same pattern. (In other words, it is the competition among entrepreneurs that guarantees that the profit rate in all sectors have a similar dynamic).The net effects of such developments and of diminishing returns to land would in the long-run lead to a stationary state, i.e. to an economy without growth.

1. Describe the Concept of Exchange according to Smith;

The value in exchange is the power of a commodity to purchase other goods- its price.

1. Why does Adam Smith dislike Mercantilism?

In Smith’s opinion, the government should interfere less in economic life than it did in Britain, where mercantilists ruled the roost. Smith had three arguments against this. First, he was critical of mercantilism as a doctrine and political practice. Regulation of trade and production had been carried out after lobbying by merchants and manufacturers, and it had led to an inefficient allocation of resources. The privileges of the guilds and the licensed monopolies favoured a few at the expense of the majority of the people.

A second argument is related to the inability of the government to regulate the economy in the interest of the majority of the people

Smith’s third argument against a large public sector is more implicit in his distinction between productive and unproductive labour. Productive labour is manifested in a good that remains when the production process is completed. Manufacturing and agricultural work are good examples. Unproductive labour includes different kinds of services. Such labour perishes in the same moment as it has been performed. Here Smith includes the sovereign, together with all civil and military servants, churchmen, lawyers, physicians, buffoons, musicians, opera-singers, etc. They are maintained by the produce of the productive labourers, ‘how honourable, how useful, or how necessary soever’ their services are (p. 331). (Compare this with the more restrictive view of the physiocrats according to which all sectors except agriculture are sterile.) If the unproductive became too numerous, their maintenance would require so large a part of the produce that it would be necessary to draw on capital. The produce would gradually diminish. Smith argued that ‘great nations are never impoverished by private, though they sometimes are by publick prodigality and misconduct. The whole, or almost the whole publick revenue, is in most countries employed in maintaining unproductive hands’ (p. 342).

1. Why does Marx say profits will fall in the long run?
2. Explain the difference in method between classical, neoclassical, historical.
3. Meaning of Schumpeter’s creative destruction
4. Keynes on MPC
5. Dynamics of Capitalism according to Marx
6. Investment function of Keynes
7. Say’s law