

Ec. 1, ~~105~~, Used Notes

This is potentially
Same content from
The Great Economists
Study Guide

#1

Mon., 9/29/03 ; Wed., 10/01

1. Karen Ward
2. ~~Ex~~ Theme of course - how to do job opps.
3. Exams - mixed, essay + multiple choice
4. Theme of unit
5. ~~Age~~ Triads
Trade, Auth., Mkt
Land, Labor, K
Rent, Wages, Interest or Return
6. Age ~~how~~ in agony
3 x-views: political, commercial, industrial
7. Pol. x-vm. - nation building - was also a class revolution. Privatizing; downsizing; fencing (enclosure)
8. 14th, 15th Golden Age; 16th, Agony. Uprooting.
9. 3 new classes
9. Spread around the world.
10. Rationalism; progress
11. Spec., good & bad

$$\text{Rent} = \text{Gross} - \text{Wages} - WK(1+i)$$

WK = working K, e.g., seed money
if K lasts,

$$\text{Rent} = \text{gross} - \text{wages} - K(i+d)$$

Fri. 10/3

①

A. $P = R + W + WK(1+i) + FK(d+i)$

1. Why is $WK \times (1+i)$?

WK is ~~consumed~~ incorp. in the product, -- seed into crop

2. Why is $FK(d+i)$

d is a fraction of "1".

3. W is paid over time, not all up front.

4. R " " " " " "

→ Land is not incorp. in P , no need to recover

Durable K is like an onion.

B. 3 revolutions: pol. - 16th
comm. - 17th
ind. - 18-19th

Heilbroner focuses on the political.

1. Created many nations - Spain, Portugal, France, Netherlands, England, Sweden, Russia

2. Created unequal division of lands.

3. 3 new classes: probes

landowners free of obligations

Capitalist-employers (who destroyed the old guilds) (and speculated in unknown markets)

4. Spread around the world.

Began w. Scotland & Ireland

N. & S. America

Africa; India; E. Indies; Australia. -- everywhere
but Japan.

C. Comm. Rev.

~~Advancing M to producers, speculating in the goods~~
New form of employment
Buy cheap, sell dear.

D. ~~Age~~ Age of Reason-merged: science, tech., innovation.

People moved to cities. Cities are creative —
e.g. Montana vs. CT & NY

✓ E. Instability-merged. Boom & Bust.

Review Qns.

- ✓ 1. 3 ways of org. society
- ✓ 2. 3 factors
- ✓ 3. How land & K differ (Paradise)? Catalyst vs. expendable.
- ✓ 4. 3 inc. points. to factors
- ✓ 5. ~~at~~ Examples of modern med. practises?
- ✓ 6. E.g. of modern commons.
- ✓ 7. 3 new classes ff. enclosure movement
- ✓ 8. How did class members differ after change from before to after enclosures?
- ✓ 9. What Frenchman most influenced Jeff & his "dynasty" (Ehrh Van Buren)?
- ✓ 10. Basis of Smith's optimism?
What leave out?
- ✓ 11. What modern U.S. political views reflect Smith?
→ Marxism?

Mercantilists.

#2

3.

1. Nationalism - 16th - 18 Cents

Displaced Church universalism (nationalism came later)
Luther, Calvin, Henry 8

2. No unified, universal theory. Not universal Colbert the emblem

3. Law of the jungle - internationally.

4. Flexible & dynamic

"From status to contract"

Sanctity shifted from religion to property & contract.

Land grabbing - shifting boundaries; fishing grounds.
Cities - Spain sought Holland & Italy.

Lebensraum

5. Tenets

a. Zero-sum trade

b. Rigging trade

- Nat. monop. import & export

- Keep colonies primitive

- Export balance.

~~Bullionism~~

✓ — c. Freedom from morality - ally w. state

d. Strong military - tempered by economy.

✓ — e. Bullionism & inflation. *Coincided w. gold from new world.*

f. Low wage rates. Enclosures.

g. Dissenters - banished then ship out

The Mercantilists - Outline

1. We begin by surveying the attitudes of the "Mercantilists."

"Mercantilist" is a generic name for a loosely similar lot of writers on business and public affairs in western Europe, from about 1500 to 1800. They did not call themselves "mercantilists" - that was a later epithet - nor think of themselves as a group, but they shared many attitudes prevailing in the age when they wrote. This was the age of nascent nationalism, supplanting a previous age of agricultural feudalism, semi-independent city-states, and a unifying or mediating universal church with strong political powers. Nationalism undercut the monopoly power of the church, some time before rationalism emerged to challenge its moral and intellectual monopoly. Churches, of course, are still strong today. Various churches are seeking to reclaim political power, and to combat science, with some success in our times. Religious wars are raging in some regions. But churches overall are still short of the monopoly power they once exercised over thought and politics.

Each mercantilist writer was likely to be pragmatic and focused on specific current issues, not seeking for philosophical generalizations, nor consistency, nor system. Their work was characteristic of that age of flux between the universalisms of the medieval church, and the later scientific universalisms of the Age of Reason. Hence, no single writer systematized all their thinking, as Aquinas did before them, and Adam Smith after them. Some of the many Mercantilists were Mun, Locke, Malynes, Child, Misselden, Serra, North, and Davenant. The most powerful Mercantilist was not a writer, but the finance minister of Louis XIV, King of France. This was J.B. Colbert, of whom you will learn more in the next episode, The Physiocrats.

2. Mercantilism was the narrow business side of nationalism. The aim of each mercantilist was to grow and benefit his own state at the expense of others, without much apology to religion. Call it "Unenlightened Self-Interest." The previous idea of a unified "Christendom" was discarded as an incubus. Indeed, even before nationalism there were mercantilists advising each city-state on how to gain at the expense of rivals and dependencies. The moral level was that of Machiavelli.

Mercantilism was more dynamic and flexible and, in a way, progressive than the static feudalism that preceded it. It saw human economic relations, previously governed by inherited "status," becoming governed instead by "contract," terminable and renewable. Sanctity, once defined by the church, became attributes of contract and property. Mercantilists saw nations being formed, and losers destroyed, and they relished the brawl (like later "social Darwinists"). Each nation needed more Lebensraum (living-space) to populate and tax and exploit: land in the form of colonies, fishing grounds, trade privileges, and even pieces of each other, so boundaries were in flux. Mercantilism was more dynamic than what preceded it, and even than some

of the neo-classical economics that followed it, because it knew no concept of "equilibrium" (a "neo-classical" notion that you will meet later).

3. Here are some of the main tenets of Mercantilism.

a. The gains from trade are not mutual - one party gains what the other loses. It's a jungle out there! Hence, a nation as a whole does not gain by fostering domestic trade, for trade yields no net gain. It gains by regulating and controlling international trade to take advantage of other nations.

b. This rigging of trade takes at least three forms.

i. W.r.t. peer and rival nations, rig the terms of trade to favor the home nation: sell dear and buy cheap. One's own exporters should not compete against one another for the benefit of foreigners, but be organized in a monopoly. Importers, likewise, should be a monopsony.

ii. W.r.t. dependent nations and colonies, cast them as providers of raw materials for home manufacturers. This was the "policy of provision." Keep them away from tertiary activities like finance and insurance, which are at the top of capitalism's hierarchy of command and control. Keep them from trading with other nations; force them to use shipping of the home nation. Establish social, financial and political ties with their major landowners, to control the lesser ones and keep them in orbit. The last device is the essential tool of control that has made imperialism possible over many centuries. If you've seen Mel Gibson in Braveheart, you saw the English King Richard I use it to control the Scots. In U.S. history, at the time of the Revolution, such people were called "Tories" - a prominent one was Oliver de Lancey of New York. In the history of India, they were called Zamindars. Hitler called them "5th Columnists" - Vidkun Quisling of Norway was a prominent one, whose name has become a synonym for traitor.

iii. W.r.t. the globe (i.e. the sum of all other nations) export more than you import, to build up gold reserves. This side of Mercantilism is "bullionism." Some Mercantilists equated gold with national wealth. Later critics of Mercantilism, especially Adam Smith, lampooned and overstressed this aspect of it, such that many students learn that it was the essence of Mercantilism. That is a caricature, however: most of them weren't that stupid. A determined critic can ferret out stupid sayings by individual members of any group, but that does not represent the best of the group.

Actually, a nation can use an export balance to build up assets abroad, and residents of successful Mercantilist nations became absentee owners of colonial assets on a large scale. Some of this was accomplished by force, but planting settlements took a lot of capital, too.

c. Mercantilists championed a modified individualism, featuring freedom from medieval church morality, but in alliance with the state. They had little faith in the free market, but rather in sheltered trading, banking, or landed privileges. In this respect they somewhat resemble the Whig Party of Henry

Clay in America, and hence both the Republican and Democratic Parties after the rigged "election" of Hayes as President in 1877 (for former Whigs then controlled both Parties). Indeed, people of that mindset still control both major parties today, although the name itself is no longer used.

d. Mercantilists gave high priority to military and naval power, to secure lands, and ocean routes, and privileged access to ports. The merchant marine and the navy were co-dependent. (James Monroe, John Quincy Adams, and Theodore Roosevelt would all have understood.)

e. Mercantilists were also "bullionists," who prized liquidity in a nation, both the quantity of gold it had, and the rate at which it circulated. They were tolerant of inflation, and even encouraged it, equating it with brisk trade and prosperity. In this respect they resembled later Keynesians.

Some of them were even concerned with full employment, and saw gold importation and inflation as means to that end. Lest they seem like champions of labor, however, read on.

f. Mercantilists championed low wage rates, privatization of common lands, and unequal distribution of wealth and income. They favored the enclosure and privatization of common and church lands, and their engrossment by a handful of royal favorites and Parliamentary leaders. This seems inconsistent with their concern for full employment, but remember, there was no consistent Mercantilist system or philosophy - Mercantilism was the product of many writers, riddled with contradictions (and, probably, hypocrisies and ruses). Also, like later Keynesians, they may well have wanted a way to keep the system working without challenging, or even examining, the basic distribution of property.

They favored low wage rates to aid exports without having to lower rents, and to use the labor supply fully without raising domestic consumption (i.e. without raising the demand for imports, and without diverting resources from exports to the domestic market).

g. Mercantilists were ambivalent and shifting about emigration of labor. As foreign land speculators and investors, they favored it, to populate their new ports and plantations. As home employers they opposed it, for it tapped into their labor pool. They generally resolved the dilemma by shipping off the more troublesome elements: jailbirds and religious dissenters, often as indentured servants, sometimes as convicts.

The Mercantilists, Questions and Answers

1. Economic philosophy before the Mercantilists was integrated into a grand, definitive synthesis by St. Thomas Aquinas, and after them by Adam Smith. What, if any, Mercantilist did the same for Mercantilistic philosophy?

None. Each Mercantilist writer was likely to be pragmatic and to focus on specific current issues, not to seek for philosophical generalizations, nor consistency, nor system.

2. Was Mercantilism in conflict with nationalism?

No. Mercantilism was the narrow business side of nationalism.

3. Was Mercantilism static or dynamic?

Mercantilism was more dynamic than the feudalism that preceded it. It saw human economic relations, previously governed by inherited "status," becoming governed instead by "contract," terminable and renewable.

4. Was Mercantilism a "good neighbor" policy?

No. The aim of each Mercantilist was to grow and benefit his own state at the expense of others. In their view, the gains from trade are not mutual - one party only gains what the other loses. It's a jungle out there!

There are echoes of this today in the attitude of the OECD (Organization for Economic Cooperation and Development), a powerful supranational body to which some countries have yielded parts of their sovereignty. The OECD believes that nations that compete to attract foreign capital are engaged in a "harmful" activity, and should be checked.

5. In what three ways would Mercantilists have a nation rig its international trade?

i. W.r.t. peer and rival nations, rig the terms of trade to favor the home nation: sell dear and buy cheap.

ii. W.r.t. dependent nations and colonies, cast them as providers of raw materials for home manufacturers. This was the "policy of provision." It is what triggered off the American Revolution.

iii. W.r.t. the globe (i.e. the sum of all other nations) export more than you import, to build up gold reserves. This side of Mercantilism is "Bullionism."

6. What is the relationship of Mercantilism to "Bullionism"?

See #5, iii, above.

7. The shift from Feudalism to Mercantilism was a change "from status to contract" as the governor of human relations. Explain what that is supposed to mean.

Mercantilism saw human economic relations, previously governed by inherited "status," becoming governed instead by "contract," flexible, voluntary, terminable and changeable.

Extra credit: explain how the above overstates the changes that actually occurred.

"Sanctity," once defined by the church, became an attribute of contract and property. Property in land was inherited, passed on for centuries, protected, and venerated like an icon.

8. Did the Mercantilists consistently favor individualism?

Mercantilists had little faith in the free market, but rather in sheltered trading, banking, or landed privileges. In this respect they somewhat resemble the Whig Party of Henry Clay in America, and hence both the Republican and Democratic Parties after the rigged "election" of Hayes as President in 1877 (for former Whigs then controlled both Parties).

9. Were the Mercantilists "hawks" or "doves" in foreign affairs?

Mercantilists gave high priority to military and naval power, to secure lands, and ocean routes, and privileged access to ports. They were constant hawks, inclined to assume that warfare and conflict are the natural human condition.

10. Where did Mercantilists stand on the rights of labor?

Mercantilists championed low wage rates, privatization of common lands, and unequal distribution of wealth and income. They favored the enclosure and privatization of common and church lands, and their engrossment by a handful of royal favorites and Parliamentary leaders. They favored low wage rates to aid exports without having to lower rents, and to use the labor supply fully without raising domestic consumption (which would raise imports).

11. Did Mercantilist philosophy fit in well with the 18th Century "Age of Reason"?

No. The ad hoc policies and inconsistencies of Mercantilism were not good enough for the Enlightenment. Physicists, biologists and chemists were popularizing new thinking that linked complex details into systems, unified by a few general principles. This is one reason that Mercantilism gave way to "classical political economy," which we study next.

~~9. Ship out dissenters~~

4

Physiocrats

1. Age of Reason French patriots, but much more.

✓ 2. Sought universal truths, or at least general principles
Ideas spread around Eur., & the U.S.A.

3. Ahead of the curve, in France.

4. Their causes.

a. Honesty in govt.

b. Laissez-faire

Anti-paternalism

c. Natalism

d. Free trade - domestically. Untaxing prodn., & sale,
K-form. Commerce clause.

e. Taxing Land instead. Product net. ATCOR

f. Taxing all owners on same basis

No exemptions

An idea lacking from modern discourse. Shultz,
Borkin, Hoover last y.

No matter if tax value - a const. based on o.v. -
or np, bcs. at $MA = MV$, is no ΔNP

In the 18th Century, the "Age of Reason," and "The Enlightenment," the ad hoc policies and inconsistencies of Mercantilism were not good enough. Physicists, biologists and chemists were popularizing new thinking that linked complex details into systems, unified by a few general principles. In this politico-economic world of new puzzles, it was time for a new thinker to step forward with a unified, coherent system of thought. One group of thinkers obliged: they pioneered ways to sort out the pieces and fit them together. We turn first to them, the French "Physiocrats."

B. The Physiocrats - Outline

1. These Physiocrats were pioneers of applied economic analysis. They were people of influence in the French court under Louis XV and XVI. Their motives were benign and idealistic, in contrast with the cynical Mercantilists. Their goal was to shape royal policies to solve real social problems at home. They observed that France, with the greatest resources and population and location, was not living up to its potential. They were French patriots motivated to strengthen their nation and raise the welfare of its people; but they thought France could learn from England, whose progress and power they admired. They preceded the English in analyzing and articulating what the English, to some extent, practiced; and in showing France how to improve on it.

2. They addressed problems specific to France, but in the process developed general principles applicable to all times and places. They wrote during "The Enlightenment," and "The Age of Reason," which led to the age of "Benevolent Despotism," when reform was in the air in every court in Europe. Ideas were international: they learned from English scientists like Isaac Newton and William Harvey, and philosophers like John Locke. Their ideas, in turn, spread widely to Europe and America. In religion they were mostly Deists, like Washington and Jefferson, while nominally Christian.

Their ideas were not purely Eurocentric, but had a strong Chinese strain. Turgot, a leader of the group, was called "The European Confucius" because of his interest in Chinese philosophy. Laissez-faire, their slogan, is Taoist. They followed an ancient Chinese tradition that "Nature ruled society" - but they called it "natural law." The idea is found in Laotze, d. 530 B.C. As for Christianity's being "Eurocentric," it is well to remember that it originated in Asia, and many scholars find Buddhist elements in the teachings of Jesus.

3. Politically, they got "ahead of the curve," and in France lost favor and power after 1776. (In Austria, under the Benevolent Despot Joseph II, their influence grew until Joseph died in 1790.) Their enemies who ousted and succeeded them paid the price in the French Revolution, from 1789, which the Physiocrats were trying to forestall.

4. Causes they championed:

A. Reforming obvious abuses: graft, corruption, tax-farming, etc.

✓ **B. Laissez-faire**

✓ C. "Natalism" - raising the birth rate

✓ D. Untaxing production, trade, capital formation, and parenthood

✓ **E. Focusing taxation on the net product of land (aka**

economic rent), the only true taxable surplus

They had strong influence abroad, e.g. in England on Adam Smith, and in America on Ben Franklin, Tom Paine, John Adams, James Monroe, and

✓ especially on Thomas Jefferson. The "commerce clause" of the U.S. Constitution, the basis of our national unity, is pure Physiocracy. The Founding Father who led in demanding its adoption was James Monroe.

✓ In trying to understand the thinking of the "Founding Fathers" who wrote the U.S. Constitution we have to understand that most of them were steeped in Physiocracy. Why should we care? The U.S. Supreme Court today often tries to interpret the Constitution according to the contemporary thinking of those who wrote it. Even Alexander Hamilton, champion of commerce, finds it necessary in his Report on Manufactures (1791) to refute a Physiocratic idea (a mistaken one) that farming is more basic than other pursuits. (He does it only clumsily, as though feeling his way through new territory - no one at that time had articulated the reasons for the tremendous productivity of urban land, which waited upon Henry George, 1879).

6. Some of them undervalued urban production relative to farm and other "primary" production. They called urban activities "sterile," because they generated no net rent (even though, in fact, they do). Another branch of Physiocrats (Vincent de Gournay, A.R. Jacques Turgot) did not buy into this quirky idea, so you may take your Physiocracy with or without it. Today, few economists overvalue primary production, but many other people still do.

The Physiocrats - Narrative

✓ 1. The Physiocrats were a group of French thinkers from "The Age of Reason" (18th Century) who mingled and found favor in the courts of Louis XV and, briefly, Louis XVI. They were at the core of "The Enlightenment" of the times - "Enlightenment" meaning to apply the findings of The Age of Reason to real life. Paris, in turn, was the leading intellectual center of Europe. Their ideas travelled east as far as St. Petersburg (Catherine the Great), and west as far as the new U.S.A. (Tom Paine, James Monroe, John Adams, Tom Jefferson, and Ben Franklin). It was actually the Americans who travelled, for all five of the foregoing lived in Paris in the 1780s, and fraternized with the Physiocrats. Some influential French Physiocrats also came to the U.S., like Pierre Samuel DuPont, and Jefferson's brilliant Treasury Secretary, the French-Swiss Albert Gallatin. Recall that Jefferson's political party, which routed the Federalists in 1800, was pro-French. Louisiana, which Jefferson joined to the U.S. in 1803,

was heavily French. Jefferson's political "dynasty" lasted a long time: through Madison, Monroe, John Quincy Adams, Andrew Jackson, and Martin van Buren – at least.

✓ François Quesnay, the leading thinker, was a physician who became personal doctor to Mme. Pompadour, favorite courtesan to Louis XV. She also did most of the heavy thinking for Louis, who preferred chasing stags and skirts. Quesnay's influence grew when he saved the life of Louis' son (a life later lost to the guillotine). Quesnay was a deep thinker and creative theorist. He explained matters in plain French, exploiting and augmenting the clarity and utility of that sophisticated language; but he also used intricate diagrams and mathematics that still beguile economists. Being a physician, he analyzed the economy in physiological terms of circulation and metabolism. Adam Smith was his pupil.

✓ Marquis Viktor de Mirabeau, a rich nobleman, was a humanist whose book title, *Friend of Mankind*, bespoke his benign attitudes (similar to those of Wm. Godwin whom we will meet later in England). Mirabeau was also a "pro-natalist," meaning he favored raising the population of France, which had been falling. Quesnay persuaded him that the route to that was a stronger farm economy.

Pierre Samuel du Pont de Nemours was a cagy politician and publisher who got the Physiocrats lots of good ink. He served for a time as Turgot's secretary. He later was to participate in the French Revolution, support a losing faction, and yet manage to survive. In 1799 he left France for America where he befriended Thomas Jefferson, and reinforced Jefferson's belief in Physiocratic ideas. With his son, a chemist, he established the I.E. Du Pont firm in Delaware, now America's most enduring family-business dynasty. (His namesake, P.S. du Pont IV, had a run at the Presidential nomination in 1988.)

Baron A.R.J. Turgot was a skillful and honest administrator. Louis XVI, when newly crowned in 1774, made him Minister of Finance. It was a time when most people saw that France needed saving from itself. He proceeded vigorously to implement Physiocratic reforms, and weaken special privileges, but Queen Marie Antoinette, who had liked him once, fired him in 1776 for refusing to hire and promote her favorites. That political mistake led him to a comfortable early retirement, and later led her to a most uncomfortable one, as he had warned.

Turgot came to Physiocracy through the influence of Vincent de Gournay, rather than Quesnay. Turgot and Gournay did not buy into the quirk for which later critics have faulted Quesnay, i.e. the notion that commerce and industry are "sterile." They were of one mind, though, on all practical policy issues.

✓ Turgot was also an intellectual, an author and an idealist - a fully rounded, admirable and independent human being. He always put Justice at the center of his system, unlike Adam Smith, who trod around it. Turgot believed in "natural rights," a popular ethical and philosophical concept of the times. Modern academic philosophers cavil at the concept that rights or law are "natural."

✓ Maybe not, but natural rights are firmly embedded in our culture: in Jewish and Christian Doctrine, the English Bill of Rights (1689), the American Declaration of Independence (1776), the Massachusetts Declaration of Rights (1780), the French Declaration of the Rights of Man (1789), the Bill of Rights in the U.S. Constitution (1789), the Gettysburg Address (1863), the United Nations Declaration of Human Rights (1946), and more orations and sermons than you could count.

2. France had a number of problems inherited from previous regimes.

A. Vast lands held by nobles (the "First Estate") and the Clergy (the "Second Estate") were exempt from taxes. The "Third Estate" (businessmen, workers, and plain folks) paid the taxes.

Most revenues came from taxes on consumption and exchange (excise taxes) and from forced labor (called the corvée) on public works and in the military. (Similar forced labor in Bohemia was called the "Robot," whence our word for a mechanical slave.) The corvée amounted to a tax on rearing children, which helped account for falling population in France. (Ironically, we are returning today to a somewhat similar tax system, and calling it "tax reform." We no longer force labor, except in prisons, but we do force people to pay special taxes for working, and again when they spend to support their families. California's Proposition 13, 1978, now shelters property from taxes above a low level, thus forcing the state to levy taxes on other bases – mainly human labor.)

B. J.B. Colbert, adviser to Louis XIV, had left France with a legacy of paternalism (or, more accurately, "dirigisme," which is the same control-freak policy but without any fatherly solicitude for the poor, infirm or aged), whereby the state micro-directed many business and manufacturing affairs.

C. The state controlled farm prices below market levels, in a clumsy effort to share the bounty of farms with the urban poor. To keep the poor quiet, the state tried in this small way to appease them for the many wrongs it did them. A harmful sideeffect was to demotivate farm production.

D. French Provinces regulated and taxed interprovincial trade, so that France itself did not comprise one common market.

E. Actual tax collections were handled by "tax farmers,"

each of whom was sold (or corruptly given) a contract for a certain region, and allowed to collect as much as he could force from the people there. This kind of "farmer" had the power of the state, without clear rules or restraints. Thus a basic tax on members of the Third Estate (commoners), called the taille, evolved under tax farming from a tax on real estate to a tax on visible wealth and expenditure.

F. No one ever heard of a merit system in the civil service.

3. The Physiocrat's impact on power

✓ Quesnay enjoyed favor at the court of Louis XV, thanks to the good graces of Mme Pompadour, Louis's favorite and Quesnay's patient. (To understand French policy, a good rule was "*Cherchez la femme*.") It was the age of "The Enlightenment," and for a time, Quesnay reigned as a guru at its center. European monarchs viewed themselves as "Benevolent Despots"; they vied to patronize artists, scientists and intellectuals, and to show their modernity and compassion by helping (or ceasing to abuse) the poor and oppressed. It was something like the "radical chic" of the 1960s in America. Frederick the Great of Prussia, Charles III of Spain, and Catherine the Great of Russia, among others, imported French intellectuals and savored their ideas - French being the universal court language.

Above all, Joseph II, Holy Roman Emperor and ruler of Austria, bought seriously into Quesnay's ideas, and set about enacting them with conviction, royal power, and determination. To give you an idea of where Austria was coming from, though, his related reforms included freeing serfs, abolishing torture, allowing freedom of worship, basing the civil service on merit, and letting peasants marry whom they wished. Austria was just emerging from the night of tyranny and oppression. The ancient oppressors, including Joseph's own family, did not appreciate his efforts. Only the people loved him.

✓ To help you remember Joseph's time and place in history, he was the patron of composers Gluck, Salieri and Mozart. Much has been made of the suspicion that Salieri may have poisoned Mozart, from professional jealousy. That may be a coded surrogate for the more plausible suspicion that someone did in Joseph himself, who died young in 1790. Privilege plays rough.

✓ Joseph's keystone reform was having all lands valued, in order to tax them "ad valorem" (in proportion to value). That was Quesnay's central proposal. It aroused fierce opposition from the First and Second Estates, who had been riding on the the Third Estate for so long they regarded this free ride as a sacred right of property. When Joseph died (or was he pushed?) in 1790, his brother and successor, Leopold II, aborted his reforms, and joined the entente against the French revolution, then just beginning. The establishment then did its best to wipe out the memory of Joseph II, and jeer at him. Not until the uprisings of 1848 was there an effort to revive some of Joseph's reforms, by which time Austria had fallen behind rival powers, never to recover.

Louis XVI, King of France from 1774, made a Physiocrat, Baron A.R. Jacques Turgot, his Minister of Finance. Turgot was a seasoned administrator with a "bias for action," who got right down to it. He pushed through new edicts ending the corvée, and

subjecting the vast estates of the nobles (the First Estate) and the clergy (the Second Estate) to taxation on the Net Product. He freed trade among the provinces, and let prices seek their own level in free markets. He proposed to end tax farming, and wipe out many other abuses and special privileges.

He also refused to let Queen Marie Antoinette pad his civil service with her friends. She got him sacked in 1776, and his laws repealed. (Ironically, Marie was the sister of Joseph II of Austria.)

Marie should not take all the onus, however, and it is perhaps only the male chauvinism of some historians that has highlighted her role. The major landowners of France, the taxexempt nobles and clergy, led in resisting Turgot. The Parlement de Paris represented these landowners. When Turgot issued an edict abolishing the corvée (forced labor), and substituting a land tax, the Parlement issued a Remonstrance against the Edict Suppressing the Corvée, 1776. It urged the King to maintain the rights of property, and also to preserve "rights attached to the person and those which derive from the prerogatives of birth and Estate." ("Estate" referred to the caste system then in place, with nobles being the First Estate, Clergy the Second, and commoners the third.) The Remonstrance warns against "mixing all the orders of the state together by subjecting them to the uniform yoke of a land tax." This would cause "disorder and confusion." "It is necessary that some command and others obey." That was the mindset of the ancien régime (old order).

Do not think that mindset passed away long ago. It was also the mindset of economists Francis Y. Edgeworth and Vilfredo Pareto, whom you meet later. The ideas of Pareto, an Italian fascist, have been adopted by much of the economics profession to justify the unequal distribution of wealth - a development that some of us consider unwholesome or worse.

It was tragic: Turgot might have been one of the great lawgivers of all the ages, like Moses or Solon. Well may he have said, "Bien rude prendr'essor avec les aigles en travaillant avec les dindons" (It's hard to soar with eagles when you work with turkeys).

Marie, meantime, began a long journey that ended on the guillotine. Her main legacy is her memorable dismissal of the starving poor, "Qu'ils mangent de brioche" (Let 'em eat cake). She was seriously out of touch, and was to pay the price. During this period, France got revenge on Britain by helping win the American Revolution (some say it was France did the heavy

lifting, and the Americans who just helped). This victory did not placate the suffering French masses, though, who took THEIR special revenge starting July 14, 1789, when they stormed the Bastille.

4. What policies did the Physiocrats champion?

A. They would reform obvious abuses like corruption,

favoritism, undue influence, graft, and tax farming. This program was more novel and shocking in 18th Century France than it might seem today.

B. They adopted the slogan of Laissez-faire, laissez-

passer, le monde va de lui-même (Let things work, let them happen, the world goes by itself). Today, we just say "Laissezfaire." This advice is aimed at control freaks in government. It bids them resign as general managers of the universe, and let people produce and trade freely, guided by market prices. Adam Smith was to borrow this concept, and time has coupled it with his name. It was novel in 18th Century Europe, but derives much from the Taoist philosophy of the ancient Chinese Lao-tze (d. 530 B.C.), whom Turgot studied and admired. Let no one say that market economics is "Eurocentric"; its central idea derives from a great Chinese philosopher.

Recall that at this time the spirit of J.B. Colbert was ascendant in France. Physiocrats were reacting against his brand of extreme dirigisme. It is unlikely they would have gone as far to the other extreme as today's anarchists, libertarians, and Ayn-Randians. Quesnay, like Adam Smith later, explicitly acknowledged the need for the state to supply capital for public works, which Quesnay called avances souveraines.

Laissez-faire meant letting prices seek their own level, free of controls. In France of that age, that meant in particular letting the price of grain and flour rise. This was the people's bread, but Quesnay et al. reasoned that the people would be more than compensated by their relief from oppressive taxes. The Treasury, in turn, would be more than compensated by the resulting rise in land rents, which the Treasury would tax.

Note that in France, laissez-faire meant raising the price of grain. In England, we will see that it meant lowering

the price - for France exported grain, while England imported it. In passing from France to England, the generic concept of laissez-faire had to pass from the particulars of an exporting nation to those of an importing nation.

Laissez-faire also meant revoking monopolies, at least those that the state granted and supported. Chief among these were the "guilds."

C. Physiocrats were pro-natalist. This meant ending the corvée (forced labor), and encouraging subdivision of large estates by taxing the land. It also meant ending consumption taxes like the gabelle (salt tax). Does a salt tax seem trivial? To us, maybe, but that tells you something about the low living standards of that time and place. Salt was a big item in family budgets, just as it was later in Ghandi's India. In case the taste for salt was insufficient, the French required each family to buy seven pounds a year.

D. They would end all taxes that are contingent on production, labor, and trade. They would nurture capital, which they clearly distinguished from land: creating capital, conserving it, and turning it over. To them, taxing trade was as bad as regulating it - they correctly perceived taxes as a form of regulating. They favored complete free trade, including freedom from excise taxes, both domestically and internationally - but with emphasis on the domestic trade (unlike today's free traders, who slight domestic trade as they hype international trade).

E. They would focus taxes on the produit net, that is the Net Product of land after deducting all costs of improvement and production. ("Net" is French for "clean," or "clear," and has been borrowed into English accounting.) We will see that the classical English economists translated produit net as "rent." Today, "rent" has taken on many confusing and conflicting meanings, even among economists, so when in doubt, think of economic rent as the "Net Product" of land.

This idea, too, has Chinese antecedents, for the land tax in China is as old as history. Remember that Turgot, "the French Confucius," was much influenced by Chinese precedents. A famous administrator who revived it during the Sung dynasty was Wang An-shih, who was chief councillor, 1069-76 (just after William the Norman conquered England). Just like Turgot, he lowered the forced labor levy and raised the land tax - only Wang partly succeeded where Turgot failed, and the Dynasty lasted another 200 years.

In the 20th Century, Dr. Sun Yat-sen revived the idea. He was frustrated during his lifetime, but the idea passed to Taiwan in 1948, where Chiang Kai-shek and his successors applied it vigorously and with great success, somewhat atoning for Chiang's miserable record on the mainland. Eastern Asia, indeed, has prospered mightily by using this principle of public revenue. Hong Kong is the most visible modern example. Japan's Meiji Restoration was financed by land taxes, and the MacArthur reforms during the occupation restored many of them, helping with Japan's astounding postwar recovery and prosperity. Singapore has prospered with heavy use of land taxes, as have the "lucky countries" of Australia and New Zealand.

The French Physiocrats did not view this tax shift as a real shift that would raise the tax burden on landowners, because they believed other kinds of taxes are shifted to landowners anyway. You can't squeeze blood out of a stone, they reasoned, so there is only one true taxable surplus, and that is rent, the Net Product of land. For an acronym, we will use ATCOR (All Taxes Come Out of Rent) for this Physiocratic doctrine of tax incidence. Mirabeau's Theory of Taxation, 1760, spelled it out. Thus, to lower the corvée and poll and consumption taxes, and replace them with taxes on the Net Product of land, would not raise the end-result tax burden on landowners. This was true even if the tax switch was "revenue neutral," i.e. would raise as much money as taxes do now. It would even lower the total burden on landowners.

How's that again? LOWER the total tax burden? This would result from unleashing the great power of market incentives, incentives to work, to save, to exchange, to produce, and to direct resources to their best uses. Such forces are now twisted and suppressed by taxes on capital, labor and exchange. Such twisting and suppression constitute an "excess burden" of

such taxation, a burden NOT imposed by taxes on the Net Product. This is the distinctive Physiocratic doctrine, one that we will find repeated in Adam Smith, David Ricardo, John Stuart Mill, and Henry George. (It is also expounded in "The Taxable Surplus of Land," a paper I presented in January, 1999, to the Russian Duma, which is on reserve for this course.)

F. They gave a lot of thought to the role of capital in production. They thought of capital as what we today call "front money" - which they called "avances". They stressed the importance of getting it back, which reflux they called "revenue" (French for comeback). This reflux is recycled (reinvested) to create new incomes. (Today we call it "turnover.")

Physiologists will see here the analogies to circulation of the blood, and metabolism of body tissues, reflecting Quesnay's knowledge of medicine. Turgot specifically credits James Harvey's science, and makes the connection. This was one of their reasons for wanting to keep taxation off capital, and focus it on the Net Product of land.

This part of their analysis was gradually lost, except among Austrian economists, who are still trying with little success to reintroduce it into Anglophone economics. This thread is important, but complex to follow, so we do not treat it in this short course.

- ✓ G. Composing "left" and "right" positions. You may have noted that the Physiocrats appear "radical" in terms of raising taxes on the rich, and lowering them on the poor. At the same time they appear "conservative" (in modern terms) by favoring free markets. Their genius was to show how to accomplish both ends at once, by focusing taxes on the Net Product of land. This is a concept that most of the polarized pundits of today still fail to grasp, 223 years after Marie Antoinette axed Baron Turgot. It is one of the main ideas you should take from this course - an idea tragically missing from modern discourse.

5. Influence on Smith, Jefferson, Paine and Monroe

Adam Smith travelled in France and studied for a time with Quesnay, to whom Smith credits many of his best ideas. Neither Smith nor Quesnay was the first to write on political economy, but most people look back to Smith as the father of Anglophone economics. First or not, Smith cast a long shadow: people still quote and revere him. Few realize their debt to the Physiocrats, who passed the baton to Smith: he published *The Wealth of Nations* the same year France lost Turgot, 1776.

Thomas Jefferson also penned a famous document in 1776. The Declaration owes a lot to the Physiocrats. Jefferson, like Franklin, Adams, Paine, Monroe, Madison and others, spent time in Paris consorting with leaders of The

Enlightenment like Turgot and Quesnay. Later he knew Du Pont and other transplanted Frenchmen in the States. Jeffersonian land policies, the basis of western settlement in the 19th Century, show the Physiocratic influence.

James Monroe is often called the father of the "commerce clause" in the U.S. Constitution (part of Article I, Section 8). This is the clause that gives Congress the power to regulate interstate commerce, and thus prevents the states from taxing trade among themselves. This idea is pure Physiocracy - see "D" above. The commerce clause is what created and sustains our huge domestic marketplace, the largest free trade zone in the world, and the basis of our national greatness.

6. Primacy of agriculture?

It was Quesnay's quirk to undervalue commerce and industry. He thought them "sterile," meaning they produced no Net Product. This quirk found its way into English thinking, too, and took nearly a century to be worked out. Jefferson even shipped on a bit too much of it. Indeed, the attitude called "agricultural fundamentalism" is still common in most nations, including ours.

Some captious critics of Physiocracy have seized on this flaw to try to discredit the whole structure of their thought. As noted above, de Gournay and Turgot were devoted Physiocrats who did not buy into the fallacy; neither should we. We may appreciate Quesnay's greatness, and forgive him this trespass. We can blame Adam Smith for exaggerating Quesnay's error. Smith did this in an unworthy effort to downplay his own debts to his French teachers by misrepresenting and belittling them.

7. Revival in the late 19th Century

Physiocratic ideas, especially of land reform, enjoyed a worldwide revival in the late 19th Century. Léon Walras (1834-1910) considered himself their intellectual and spiritual heir and successor. He penned vigorous attacks on land monopoly, as well as on French academic economists who supported it (*Théorie d'Économie Sociale*). In Germany, H.-H. Gossen revived the Physiocratic position; in England, James Mill, his son J.S. Mill, and the evolutionist A.R. Wallace; in America, Henry George; in Russia, Count Leo Tolstoy; and in Sweden, Knut Wicksell. The practical counterpart of this intellectual movement was a notable rise in dependency on the property tax, rising to a peak in about 1920 in the U.S.A.

The Physiocrats, Q & A

1. Were the Physiocrats narrow nationalists?

Patriots, yes; narrow, no. They addressed problems specific to France, but in the process developed general principles applicable to all times and places. In this respect they resembled the author of the Declaration of Independence, who was one of their students.

2. Were the Physiocrats influential in politics?

They were people of influence in the French court under Louis XV and XVI. They got "ahead of the curve," and in France lost favor and power after 1776. They had some vogue in many European courts. In Austria, especially, under the Benevolent

Despot Joseph II, their influence grew until Joseph died in 1790. They had strong influence abroad, e.g. on Adam Smith and Thomas Jefferson. In trying to understand the thinking of the "Founding Fathers" who wrote the U.S. Constitution we have to understand that most of them were steeped in Physiocracy.

3. Where did the Physiocrats stand on free markets?

They adopted the slogan of Laissez-faire. Let people

produce and trade freely, guided by market prices. Adam Smith was to borrow this concept, and time has coupled it with his name. It has been hypocritically "kidnapped" by various neoMercantilists and other privileged groups to support policies the original Physiocrats opposed. Confusing? Modern economics has become a jungle of semantic manipulation - we are here to learn to deal with it.

4. Who were some leading Physiocrats?

Dr. François Quesnay, Baron A.R. Jacques Turgot, Pierre Samuel du Pont, Marquis Viktor de Mirabeau, Vincent de Gournay, and others: quite a large clique. If all those names are hard to retain, just remember Quesnay (keh-NAY), the heavy thinker, and Turgot (tour-GO) the practical man-of-action. Americans will also have no trouble remembering Du Pont, friend of Jefferson.

5. What economic problems did the Physiocrats see in France?

Most revenues came from taxes on consumption and exchange

(excise taxes) and from forced labor (called the *corvée*) on public works and in the military.

The state micro-directed many business and manufacturing affairs.

The state controlled farm prices below market levels. A harmful side-effect was to demotivate farm production.

French Provinces regulated and taxed interprovincial trade, so that France itself did not comprise one common market.

Actual tax collections were handled by "tax farmers."

No one ever heard of a merit system.

6. What tax policies did the Physiocrats endorse?

They would end all taxes that are contingent on production, labor, and trade. They favored complete free trade, including freedom from excise taxes, with emphasis on freeing domestic

trade (unlike today's self-styled free traders, who hype international trade while taxing domestic trade, production, and labor).

They would focus taxes on the produit net, that is the Net Product of land after deducting all costs of improvement and production. This accomplished two ends at once. One, it raised revenues without taxes on production, labor, or trade. Two, it asserted a kind of "co-proprietorship" of land by the state.

7. Were the Physiocrats on the "left" or the "right" of the politico-ideological spectrum?

The Physiocrats appear "radical" in terms of raising taxes on the rich, and lowering them on the poor. At the same time they appear "conservative" by favoring free markets. Their genius was to show how to accomplish both ends at once, by focusing taxes on the Net Product of land. It is one of the main ideas you should take from this course.

8. Did the Physiocrats undervalue commerce and industry?

Some did; others did not. De Gournay and Turgot were ardent Physiocrats who did not buy into the fallacy; neither should we.

9. Did Physiocracy die away?

Physiocratic ideas, especially of land reform, enjoyed a worldwide revival in the late 19th Century. The practical counterpart of this intellectual movement was a notable rise in dependency on the property tax, rising to a peak in about 1920 in the U.S.A. As for laissez-faire, that was never stronger than in the oratory of today, but unfortunately only in a hypocritical form that endorses taxes on production, labor, and trade, and leaves out the taxation of land rents.

Adam Smith I (pp. 42-59)~3

1. Desperate poverty and exploitation of landless proletariat - condition Heilbroner keeps recapping, and with good reason. Review Introduction #4, "The Enclosure Movement."

2. Quesnay, Smith, and the search for understanding Social relations as a System a Living System, like anatomy. The 18th Century was the "Age of Reason," and "The Enlightenment." Physicists, biologists and chemists were popularizing new thinking that linked complex details into systems, unified by a few general principles. It was time for a new thinker to step forward with a unified, coherent system of thought for political economy: to sort out the pieces and fit them together. We have seen how the Physiocrats pioneered the process in France. Adam Smith carried their ideas into the English-speaking world, and in the process clarified and expanded them. His weighty but readable book, *The Wealth of Nations*, became and remains a classic landmark of political economy.

Smith was "system-minded." He wrote at a time when Linnaeus had shown how all living things are related in a grand system. Von Humboldt was exploring the dynamic interactions among all living creatures, pioneering what we now call "ecology" (and he called *Kosmos*). Lavoisier distinguished between elements and compound substances, showed the role of oxygen in combustion and physiology, and began the process of classifying the elements. Newton's Laws of Motion and Law of Gravity had reduced the previous confusion of physics and astronomy to a few simple, consistent, universal rules. With such inspiration, Adam Smith sought to do the same for political economy.

3. Laissez-faire
Smith borrowed this French Physiocratic slogan and turned it into a common English phrase. He saw the market as an overall system that organizes economic life dynamically. It regulates itself through flexible goods prices; these act as "thermostats": high prices attract more competition, so overpricing cures itself, and vice versa for low prices. (Today, we call the thermostat effect "Negative Feedback," a term you should remember.) Excessive incomes for some producers, likewise, are held in check by competition. If Joe is overcharging you, go into his business yourself - it's a free country. (If "Joe" is GM or Edison or Exxon, with piles of wealth and lobbyists, that may not be so easy - but we'll get onto that later.)

4. The Invisible Hand
Smith had a colorful way with words. He called

the market an "invisible hand" that guides each private party to act in the overall public interest, "even though that is no part of his intent." All are selfishly scrambling to seek their own private interests, yet they serve the public interest more effectively than any king or government could command them. This idea has been, and remains, enormously influential in our world. (Adam Smith left a lot of loose ends. For example, he applied these ideas only to goods prices. He did not address the labor market as such, nor the land market, nor capital markets. J.S. Mill did so, later.)

- ⑤ The Division of Labor (Specialization)
Smith went beyond the Physiocrats in observing that the gains from trade include a greater ability to specialize. He summed up his view in this: "The division of labor is limited by the extent of the market." Adam Smith favored widening markets as much as possible, to enable more specialization, which he saw as an unmixed gain.

Quesnay et al. were suspicious of cities, seeing them as sterile at best, and parasitic at worst. Smith, by contrast, was an urbanist. He saw cities as centers of specialization, ferment of ideas, and technological advance. For example, the number of patents issued per capita is many times higher in urbanized New York, New Jersey and Connecticut than in rural, anti-intellectual Montana, where real men go out a-huntin' and a-fishin' when they aren't a-ropin' dogies or a-hasslin' evee-loo-shunnists. He saw that farming depends on cities as much as cities depend on farming: gains from trade are mutual. Mutuality is central to Smith's thinking.

- ⑥ Mutuality of Gains from Trade
Adam Smith stressed that trade only occurs when both parties gain, so it is mutually beneficial. Mercantilists, recall, had assumed that one party always exploits the other.

- ⑦ Wealth of Nations - meaning the whole nation
Adam Smith's work addressed the general welfare more completely than previous writers had. He said the objective of policy is to enhance the wealth of the whole nation (hence his title), as opposed to some small segment like gold hoarders, the Treasury, or landowners, or the stock market. Today, Adam Smith's viewpoint seems obvious; yet modern media pundits who measure the nation's welfare by the level of the stock

or GDP, NBER (Hansen/Justin.)
market are regressing from what Adam Smith made obvious.

⑧. Does Smith apply today?

The issues Smith raised remain hot today, and probably always will.

⑨. Perversions of Adam Smith peddled in his name.

Smith's espousal of laissez-faire was more balanced and moderate than that often preached in his name today. For example, he did not favor privatization of public utilities. He deplored monopolies, and concentration of wealth. He disapproved of unearned incomes. He observed that the main purpose of government is to protect the owners of property against the proles, and therefore the owners of property should pay the taxes. He was humane and tempered and practical and reasonable in his approach to life, and anything but an ideologue or extremist libertarian. He was the opposite of "doctrinaire." Yet modern doctrinaires use him, as they use so many innocent ancient philosophers, to support ideas that he actually opposed.

Qns. for Candidates

<u>Person</u>	<u>Position</u>	<u>Qn</u>
Arnold	Agri taxes	a. What kind of taxes
		b. How support schools?
Camejo	Tax hi incomes	c. show us some evicted widows pre 1978
		a. How about rich people w. low taxable income?
	Tax corps	b. " " ptvsps + proprietorships
Cruz	Sp. & sold	a. Why exempt imputed resid. inc?
	Open borders	b. Why was Chavez for closed borders?
Mc Chinkock	No car tax	a. How ration use of hiways?
		b. How build new hiways w/o taxes?
Arianna	Tax business	a. How?
		b. Why not merge w. Camejo?

Jasmin Chun Mon. 11

Adam Smith (II) (pp. 59-74)

1. Ugliness of life for "the unprofitable poor."

Heilbroner reminds us, as he does so many times, that the enclosure movement, ripping labor away from the land, left England with a landless proletariat who lived in desperate poverty and insecurity. If no employer could make money by hiring them, they were "unprofitable," hence had virtually no right to exist on this earth. If no one could make money selling or renting them land, they had no right to any place to live - not even a place to pitch a tent and lie down at night.

2. "Laws of Motion" of a free economy.

These are different from Newton's Laws. This is a Marxist concept that Heilbroner has borrowed to describe each writer's view of what the future holds. Smith himself did not use the term.

*Forecasts,
long term*

Adam Smith's historical "Law of Motion" was one of steady

✓ advance, made possible by capital accumulation: "upwards to Valhalla," as Heilbroner puts it. He saw capital as the cure for poverty, always making more jobs for workers, never displacing them. He saw no limits to growth imposed by nature, although he did see concentration of landownership as a bar to the prosperity of Spanish colonies. (He said little about concentration in England itself, possibly because he needed a patron, and his was the wealthy English Duke of Buccleuch. It was safer then, as it remains today, to dump on foreigners.)

3. "Law of Accumulation": Capital formation and its benefits

Smith saw capital formation driving down interest rates, and hence the need for returns to capital, thus letting labor have more of the product. He overlooked that lower interest rates make for higher land rents, so it may be land, not labor, that gains from lower interest rates. His successors Malthus, Ricardo and Mill were soon to correct this oversight, and Henry George was even to predict that landowners would reap MOST of the gains of progress (tried to buy a home lately, or rent a store?). Marx and George highlighted how capital may sometimes substitute for and displace labor, as happened during the Enclosure Movement. Ricardo showed how low interest rates may cause the misuse of capital, offsetting the gains from having more capital (this course is too short to develop that important idea.) However, most modern economists, following J.B. Clark and Francis A. Walker

and Richard T. Ely, have regressed to embrace this error of Adam Smith. We wouldn't care what these "dead old white men" thought, except that their ideas now dominate the IMF and guide its disastrous policies of austerity (which go by confusing misleading names like "liberalization," and "monetarism").

4. The equilibrating "Law of Population": Higher wages lead to higher population.

This was simply an error, that few heed any more. There is too much evidence to the contrary.

5. The equilibrating "Law of Accumulation": Abundance of capital drives down interest rates.

See #3, above.

6. Immediate uses (misuses) of Smith at the hands of others:

Smith is used by some to talk down labor organizations, public education, welfare measures, and public regulation and/or ownership of natural monopolies.

Interested parties ever since Adam Smith have used his name to talk down labor organizations, public services of all kinds, public education, and welfare measures. Those were not his main points at all: he actually favored public ownership of utilities, for example. Although he was system-minded, and created a system of thought, he tempered his generalizations with common sense and frequent references to historical experience and real life. It is not until we get to Edgeworth that we find a "Dr. Strangelove" of an economist who carries abstract ideas to their logical conclusions, however absurd and inhumane those may be. Smith was humane and well-tempered - always a pleasure to read. Smith would never have imposed on us the toll road on Highway 91, or the deregulation of power in California, or the fiasco of the 1990s in Russia, all done in the name of the free market by fanatic ideologues misquoting Smith.

A. SMITH - Questions~3A

1. Why was there a large landless proletariat in England in 1776, when Smith wrote *The Wealth of Nations*?
2. Did Adam Smith address the cause of labor's problem directly?
3. How did Adam Smith say that the market regulates prices, volume of production, and the incomes of producers, all in the general public interest?
4. Where did Adam Smith stand on free trade?
5. What is "laissez-faire"? Why did Smith borrow a French expression?
6. What is "consumer sovereignty"?
7. What did Adam Smith say about specialization?
8. Was Smith a long-term optimist?
9. All great thinkers get "kidnapped" by lesser thinkers who use their ideas and names in ways that were no part of their intentions. How was Adam Smith misused?

A. SMITH - Answers~3B

1. a. "The idea of labor as a commodity dates from the "enclosure movement" of the 16th Century." This movement privatized lands previously common, and in the process wiped out small landholdings, cutting the former owners adrift, with nothing to sell but their labor.

b. The movement began, and moved very fast, when Henry VIII was King of England.

2. Not in the main, although he now and then shows his sympathy for the landless workers, and identifies land rents as unearned income, and criticizes large landholdings and speaks well of societies with more equal distribution.

Aside from that omission, Adam Smith's work addressed the general welfare more completely than previous writers had. He said the objective of policy is to enhance the wealth of the whole nation (hence his title), as opposed to some small segment like gold hoarders, the Treasury, or landowners, or the stock market. Today, Adam Smith's viewpoint seems obvious; yet modern media pundits who measure the nation's welfare by the level of the stock market are regressing from what Adam Smith made obvious.

3. Smith was "system-minded." He wrote at a time when Linnaeus had shown how all living things are related in a grand system, and von Humboldt was exploring the dynamic interactions among all living creatures, pioneering what we now call "ecology" (and he called Kosmos). Adam Smith saw the market as an overall system that organizes economic life dynamically. It regulates itself through flexible goods prices; these act as "thermostats": high prices attract more competition, so overpricing cures itself, and vice versa for low prices. Excessive incomes for some producers, likewise, are held in check by competition.

Smith called the market an "invisible hand" that guides private parties, each selfishly seeking his own interest, to act in the overall public interest, "even though that is no part of his intent."

Adam Smith applied these ideas only to goods prices. He did not address the labor market as such, nor the land market, nor capital markets. J.S. Mill did so, later.

4. Smith favored free trade, and criticized "mercantilists" who favored tariffs to keep English gold from leaking abroad. Smith, like his mentor François Quesnay, favored free trade within the

nation as well as outside it, and would most likely have disliked what passes for free trade today, when internal or domestic trade is heavily taxed. As for outsourcing to low-wage countries,

Smith never had to face that issue.

Adam Smith stressed that trade only occurs when both parties gain, so it is mutually beneficial. Previous writers had assumed that one party always exploits the other.

5. "Laissez-faire" means, literally, "let it happen." It means government should let the market regulate trade, without intervening. In practice it is often applied selectively, with government intervening on the side of property, but that was not the intent of Adam Smith

A Frenchman, François Quesnay, had coined the phrase. Quesnay was reacting against the extreme paternalism and stifling

regulations of the French monarchy, and also against France's internal trade barriers, imposed by every province against the others. His original goal was internal free trade; international free trade was a by-product. In Smith's hands, however, it came to refer mainly to international free trade.

6. Consumer sovereignty means that producers have to supply what consumers want, or lose money. The expression is not found in Adam Smith, but expresses his ideas compactly.

7. "The division of labor is limited by the extent of the market." Adam Smith favored widening markets as much as possible, to enable more specialization, which he saw as an unmixed gain.

8. Adam Smith's historical Law of Motion was one of steady advance, made possible by capital accumulation. He saw capital as the cure for poverty, always making more jobs for workers, never displacing them. He saw no limits to growth imposed by nature.

He saw capital formation driving down interest rates and needed profits, thus letting labor have more of the product. He overlooked that lower interest rates make for higher land rents, so it may not be labor that gains. His successors were soon to correct this oversight, but most modern economists, sadly, have regressed to embrace the error of Adam Smith

9. Interested parties ever since Adam Smith have used his name to talk down labor organizations, public services of all kinds, public education, and welfare measures. Those were not his main points at all: he actually favored public ownership of utilities, for example.

Mon, Oct. 13

Smith, II

1. Unprofitable poor
2. Upward to Valhalla
- ✓ 3. Cap. accum. as process - cf. Physios, Malthus, Ricardo
Rising tide lifts all boats
4. Higher wages $\rightarrow$ higher pop.
5. $\Delta K \rightarrow -\Delta i$
6. Humane - not an ideologue (Lincoln)
- ✓ 7. Modern issues not faced.
 - a. Comm. environment
 - b. Disparity
 - c. Mkt. power
 - d. Outsourcing

Gloomy Presentiments of Robert Malthus

1. Prevailing Sentiment of Pro-Natalism. Three legs: Militarism, Godwinian Perfectionism, Smithian Optimism.
2. Malthus' Spectral Model: Exponential growth of population; arithmetic growth of food production; fixed land; limited ability to substitute labor or capital for land.
3. Malthus gave ammunition to reactionaries, and has been doing so every since. Malthus led to Darwin – so far, so good, no great harm done. But Darwin led to Francis Galton and elitist eugenics, which led to or supported Teutonism (in Germany), supported racism in the U.S.A., and fascism everywhere.
4. Ricardo noted how the Malthusian Effect divides society into classes: landlords who have, proletarians who have not.
5. Malthus' over-emphasis on food and farmland, overlooking fixity of other natural resources. Fallacy of identifying "landlord class" with farmers.
6. Malthus on poverty: it is inevitable, there is no way out.
7. Advice to poor: choose between food or sex. Advice to rich: avoid private charity and public welfare.
8. Is India an example of "overpopulation" causing poverty? Heilbroner says yes; Amartya Sen says no, the bogey of overpopulation is just a screen for tyranny, the real cause of poverty.
9. Fall of birthrate after Malthus; ^{Nine} ~~Eight~~ causes given.
10. Advances in land-saving, labor-using capital and technology in farming and other industries belie Malthus' forecast. Productive power of enhanced specialization: Adam Smith
verified. *Rise of food supply, 13 reasons given*
11. Malthus' other pessimism: Over-production. His ability to hold two contradictory views at the same time.
12. Enduring truth in Malthus: fixity of natural resources, need to husband them carefully.

Ehrlich v. Simon

"Just you wait, ..."

T. MALTHUS - Questions

1. What fault did Malthus find in Adam Smith's "Law of Accumulation" of capital, that kept Thomas Malthus from sharing the optimism of Adam Smith?
2. Explain the meaning of "arithmetic" and "geometric" growth rates, either verbally, or graphically, or algebraically, or with numerical examples. Which kind of growth rate did Malthus forecast for population, and which for food supply?
3. How did Malthus's ideas undercut the demands of labor for a larger share of the pie?
4. How did Malthus's ideas refute Adam Smith's idea of the harmony of economic interests?
5. What advice did Malthus have for the poor, and for the rich?
6. Is India an example of overpopulation, as H. asserts?
7. Why did the birthrate in England and Europe fall after Malthus wrote?
8. Why did food supply rise more than Malthus thought possible?
9. Is there enduring truth in Malthus?

T. MALTHUS - Answers

1. Adam Smith focused on the role of capital, and how it is indefinitely augmentable by human action. Malthus focused on land, whose supply is fixed, imposing a limit on growth - at least, on certain kinds of growth.
2. An arithmetic growth rate proceeds in equal steps, as 2,4,6,8,10, ... etc. A geometric rate proceeds in equal ratios, as 2,4,8,16,32,64, ... etc. On a graph, the arithmetic rate makes a straight line; the geometric rate curls upwards.

Malthus forecast an arithmetic growth of food supply, and a geometric growth of population, leading to general starvation among those not owning land.

3. Malthus said that raising wage rates would simply raise the birthrate, hence the supply of those seeking work, and seeking to buy food, thus forcing real wage rates back down. Thus, poverty for the landless is inevitable, there is no escape, and efforts to help the poor are self-defeating.

4. Malthus saw no harmony between the landowners and their workers, but a growing gap as food prices rose and wage rates fell.

5. To the poor, Malthus posed a harsh choice: you must choose between food or sex (birth control was not an option). To the rich, Malthus advised against charity, either public or private: it would only raise the birthrate, and defeat itself.

- 6. India is poor and populous, but there are more crowded countries that are not poor, like Japan, England, or Belgium. There is the recent example of China, whose output per capita has risen much faster than that of India in the last 20 years or so. There are nations with low population density whose people are poor, like Brazil and Russia. Many observers fault India's rigid class structure, and resistance to land reform.

7. Many reasons. Here are a few - perhaps you can think of more.

- a. Urbanization - it lowers b.r. everywhere.

- b. Delayed marriage - the Irish and French practice.

- c. Laws against child labor.

- d. Need for extended education.

- e. Need for thrift - a French attitude, brought on by very high land prices, also observed today in Japan.

- f. Periods of depression. Example of U.S. during the 1930s.

- g. Advances in technology of contraception.

- h. Decline of sexism, coupled with rising need for women to work outside the home, to make ends meet.

- i. Changes in religious attitudes - in practice, if not in official teachings.

j. Higher incomes - history seems to show that Malthus had it backwards, and higher incomes actually tend to lower birthrates.

Decline of warfare.

8. Rise of food supply, reasons.

- a. Expansion onto new lands, worldwide.
- b. Replacement of animal traction by machines. (Draft animals used to occupy or eat the produce of 1/3 of all land in farms.)
- c. Substitution of higher-yielding crops for lower, e.g. vines and tree-fruits for grain and grass.
- d. Advances in genetics, bio-chemistry, agronomy, etc.
- e. Advances in fertilization, pest control.
- f. Synthetic fibers replace some sheep and cotton.
- g. Growth of world trade, with higher specialization, fitting crops to more appropriate soils and climates.
- h. Advances in irrigation technique, doing more with less water.
- i. Subsidies to farming, a worldwide phenomenon.
- j. Advances in storage and transportation and distribution of food crops. Abating losses and wastes is the same as producing more food.
- k. Advances in knowledge of nutrition: better health with less food.
- l. Exemption of food from most sales taxes.
- m. Use of farming as an income tax shelter.

Problem of obesity.

9. Yes, there is an important truth in Malthus: land is finite, "they ain't making any more of it." Creating capital, the panacea of Adam Smith, does not create more land.

However, the policy implication of the above is not that labor is doomed to starvation wages. Rather it is that we should make intensive use of the land we have, and let no one waste it nor hog it. This was the message of Henry George.

Beginning about 1890, with J.B. Clark, the economics profession was taken over by "neo-classical" economists who revived Adam Smith's idea that capital formation is a panacea. The important truth of Malthus, that Earth has limits, had to be revived from outside the profession by conservationists, environmentalists, pacifists, nutritionists, anthropologists, ecologists, and nationalists (opposing immigration). This struggle is still going on.

- ✓ a. Urbanization
- b. Delayed marriage
- c. End of child labor
- d. Extended education
- e. Housing shortage
- f. Depressions
- g. Contraception, 1967 watershed
- h. Women's lib., + need for DINKS
- i. Weakening hold of church
- j. Higher incomes
- k. Fewer wars

-
- ✓ Rise of food supply
 - a. New lands
 - b. Machine traction
 - c. Higher-yielding crops
 - d. Genetics, agronomy
 - e. Chem. fertilizers, pesticides
 - f. Syn fibers
 - g. Trade, specialization
 - h. Irrig. technique (barely scratched surface)
 - i. Subsidies to farming
 - j. Storage, ^{processing} ~~transport~~, distribution, - cutting waste

k. Nutrition science

(Problem of obesity)

l. Food exempt from sales tax

m. Farming as inc-tax shelter

BARBERSHIP MODEL OF DIMINISHING RETURNS, MARGINAL PRODUCTIVITY, AND RENT.

FOR ECON. 001

This model presupposes a barbershop with three chairs, on a side street with a limited number of possible customers.

The owner pays each barber \$100 a day, and keeps the revenues. (These artificial assumptions are for simplicity, while we work out the main wrinkles, which are complex enough for a beginning.)

The first barber brings in \$300 a day, because he is always busy. Adding a second barber adds only \$200 a day to revenues. This is not because he is a worse barber, but he takes some customers from the first barber. There are more customers overall, because there is less waiting.

We go on from there, adding barbers.

Δ (delta) is a universal symbol for a small increment. Economists call it the "Marginal" amount.

Σ (sigma) is a universal symbol for a sum or total.

	No. of	barbers		Value	of	Revenues		Net	Revenues		ϵ	
	(1)	(2)		(3)	(4)	(5)		(6)	(7)		(8)	
	Δ	Σ		Δ	Σ	Average		Δ	Σ			
(a)	1	1		300	300	300		200	200			
(b)	1	2		200	500	250		100	300			
(c)	1	3		100	600	200		0	300			
(d)	1	4		50	650	162.50		-50	250			

Complete the following exercises, to be sure you learn the above.

1. Explain how Net Revenues are derived from columns (1)-(4)
2. Construct a graph with col. (2) as abscissa, and the other cols. on the ordinate.
3. How many barbers are optimal? (The answer may lie between two rows.)
4. Traffic declines, so row (a), with marginal revenue of \$300, is wiped out. Adjust the other three rows accordingly.
5. Indicate the max values in each column. Explain why they fall in different rows.
6. Ricardo's "margin of production" would be represented by the penultimate (next to last) row (row "c") taken alone. Explain why.
7. Make a column (8) for the Elasticity of Production (ϵ). This is the ratio of the Marginal Product (col. (3)) to the Average Produce (col. (5)).
 - a. Explain why

- b. Explain what it means, and what it is used for.
- 8. Show the effect on net revenues of three kinds of taxes, each at a rate of 50%.
 - a. On gross revenues
 - b. On payroll
 - c. On net revenues

Outline: Diminishing Returns and Rent

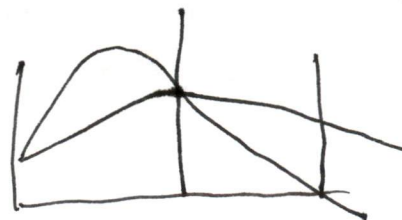
Econ. 1, Oct. 20-24, 2003

1. Ways of measuring and expressing the product: marginal, average, total, and net.
2. Tabular and graphic presentations.
3. Margin of production
 - a. Intensive
 - b. Extensive
4. Quantum leaps.
5. Wage = marginal product (MP) of labor.
6. Average Product (AP) > MP
7. Ways of measuring and expressing Net Product (rent):
 - a. Total Product (TP) - Total Costs (TC)
 - b. $[AP - AC] \times \text{units of labor}$
 - c. Sum of the marginal rents
8. Maximizing AP is a false goal.
9. Elasticity of Production (ϵ)
Why $\epsilon = MP/AP$
10. Smoothing the curves, graphically.
11. Extending the curves into new territory (Stages I and III)
12. The stages of production

Stage	ϵ	Returns		
		Average	Marginal	Total
I	>1	Rising	Rise then fall	Rising
II	$0 < \epsilon < 1$	Falling, >0	Fall to 0	Rising
III	<0	Falling, >0	<0	>0 , falling

- Cusp $\epsilon=1$; const.; $MP=AP$; rising
 - Cusp $\epsilon=0$; falling; $MP=0$; ~~Falling~~

13. Examples



Stage I. Distributing water, power, gas, etc. Market limited by demand restriction. Analysing this calls for converting product data to cost data, to set against falling demand curve. We cover this later, under Alfred Marshall.

Stage II. The condition for competition and market solutions: our "Adam Smith" condition, which we have assumed thus far.

Stage III. "Tragedy of the Commons," e.g. highways with unlimited free access. Groundwater

14. [TO BE CONCLUDED]

Graphic presentations of TP

- a. ΣMP
- b. $AP \times Labor$
- c. Separate curve

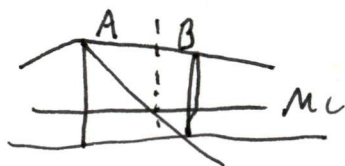
Graphic TC

- a. ΣMC
- b. $AC \times Labor$
- c. Separate Curve

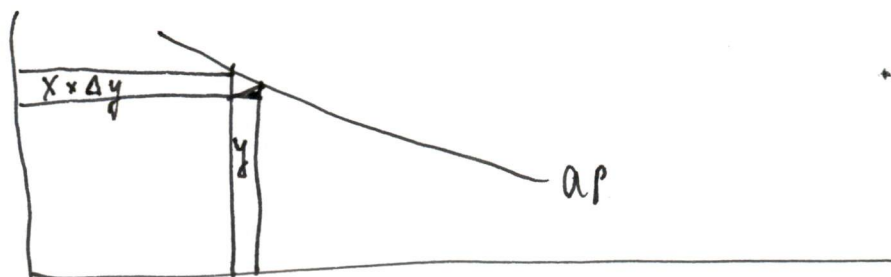
Graphic NP

- a. $\Sigma (MP - MC)$
- b. $Labor \times (AP - AC)$
- c. $TP - TC$

15. Stage II A + II B



16. $MP = \text{slice less slab.}$ e.g. app. trees.



Wed. Oct. 26

Summary, Dim. returns & rent

1. Mgn. b., ave., total, NP

2. Tabular & graphic

3. Margin of produ.

- Intensive

- Extensive

4. Quantum leaps

5. Wage = MP

6. $AP > MP$

7. Surplus = rent

a. $TP - TC$

b. $[AP - AC] \times \text{units}$

c. $\Sigma \text{Mgn. rents}$

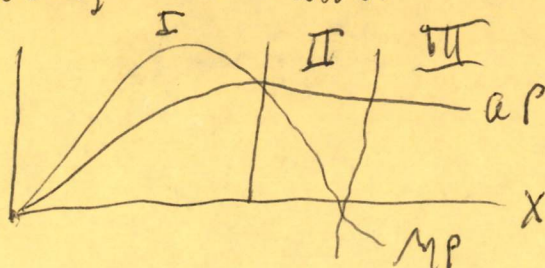
8. Max. AP is false goal

9. ~~Smooth~~ $\frac{MP}{AP} = E$

$$\frac{\Delta P / \Delta x}{P/x} = \frac{\Delta P/P}{\Delta x/x} = \frac{\eta_P \Delta P}{\eta_x \Delta x}$$

10. Smoothing the curves

11. Extending the curves



12. ~~Example~~ Stages & E

<u>Stages</u>	<u>E</u>	<u>Returns</u>		<u>Total</u>
		<u>Ave</u>	<u>Signal</u>	
I	$E > 1$	Rising Ave P	Rise, fall	> 0 , rising
II	$0 < E < 1$	Fall, > 0	Fall to 0	> 0 , rising
III	$E < 0$	Fall Fall, > 0	< 0	> 0 , Falling

13. Examples

St. I

II

III

Elasticity of Production (ϵ), and Playing the Percentages

1. Definition

Elasticity of production, *epsilon*, is denoted as " ϵ ".

ϵ is the fractional growth in the product, P'/P , from a small fractional increment of input, X'/X :

$$\epsilon = P'/P \div X'/X \quad (1)$$

To simplify, ϵ is also rewritten this way:

$$\epsilon = P'X/X'P \quad (2)$$

Expressions with ϵ are simplified by noting that $X'=1$, because X is the independent variable. Then, from (2):

$$\epsilon = X(P'/P) \quad (3)$$

For those who know calculus, ϵ is the ratio of two log derivatives. That makes it a fairly complex concept. It is two steps beyond a simple derivative - an idea that beginning calculus students find hard enough when taken alone. P' is a derivative (P' is short for dP/dX). P'/P is a log derivative. So is X'/X (which simplifies into $1/X$). The log derivative is simply the derivative divided by the variable itself.

Even so, ϵ is fairly complex (but see #2, below, which makes it simpler). Don't be dismayed if it takes a while to wrap your mind around ϵ . Its basic purpose is not to complicate life, but simplify it. It is a way of uncluttering equations, of organizing fairly complex thoughts in a compact, mnemonic, manipulable package. It helps us see the relationships of things. That will be our persistent goal in using it.

2. ϵ as MP/AP

Rearranging terms in (1) yet again,

$$\epsilon = P'/X' \div P/X = MP/AP \quad (4)$$

This (4) is a useful, simplifying, and insightful relationship. Suddenly, this mysterious ϵ relates to something we know well, from way back. From this, we can infer values of ϵ at any point on a traditional graph of a production function.

The values are approximate in between critical points, and exact at those critical points.

<u>Location</u> <u>on Graph</u>	<u>Value</u> <u>of ϵ</u>	<u>Comments</u>
Stage I	>1	MP>AP. Increasing average returns to X; (implies negative marginal returns to fixed factor)
Max AP of X	1	Constant returns to X
Stage II	1> ϵ >0	Diminishing returns to X
MP = MC	MC/AP	Optimal combo
Stage II,B	<MC/AP	MP<MC. Incurring marginal losses on each increment to X. Stage of negative marginal rents.
MP = 0	0	Zero marginal returns to X; max AP of fixed input
Stage III	<0	MP<0. Negative returns to X; (implies increasing returns to fixed factor)

We can also infer values of MP from known values of AP:

$$MP = AP \times \epsilon \quad (5)$$

ϵ is only meaningful and valid at a point, since its value changes from left to right on the graph. It is tolerably stable for small changes, especially where AP is stable. It is not valid over a long reach, and certainly not valid way back to the origin.

IMPORTANT READING INSTRUCTIONS: NOW SKIP SECTIONS 3 & 4. GO DIRECTLY TO #5.¹ Treat #3 and #4 as a technical appendix.

¹If you pass "GO" collect \$200.

3. Exponents as values of ϵ

A mathematical insight from this technique is that an exponent is an elasticity, when the base is the variable. Likewise, once you know ϵ you can write the production function using ϵ as an exponent of the variable input. Anything that helps you deal with logs and percentages is bound to be useful sometime, so we'll demonstrate it here. To show this, we write the production function in exponential form. See text after Equation (12) for more on this.

$$P = kX^\alpha \quad (6)$$

(where k and α are "parameters"²)

$$P' = k\alpha X^{\alpha-1} \quad (7)$$

But from (6), $P/X = kX^{\alpha-1}$, so

$$P' \div P/X = \alpha \quad (8)$$

Remember, from (3) and (4) that $P' \div P/X = \epsilon$, and $\epsilon = MP/AP$, so:

$$\alpha = \epsilon = MP/AP \quad (9)$$

That can also be done with log derivatives. First, take the log of both sides of (6):

$$\ln P = \ln k + \alpha(\ln X) \quad (10)$$

Differentiate both sides w.r.t. X (the log derivative of y is y'/y):

²You could also say they are "constants." The word "parameter" means a number that is constant for the time being, but may be changed later, as the facts change. π is a constant that is not a parameter, it never changes.

$$P'/P = \alpha X'/X \quad (11)$$

$$\alpha = P'/P \div X'/X = \epsilon \quad (12)$$

As aforesaid, once we know ϵ and k we can write the production function in the exponential form (6). (6) is good shorthand for expressing something about production functions.

It is a question, though, how close it comes to representing reality on a broader canvas. (6) only applies for small changes of X . Those who depend too narrowly on it run the danger of forgetting that ϵ changes as X changes. They are prone to assuming constant values of the exponents "for simplicity," or "to make the equations more tractable to solving," or "mathematical elegance," or "rigor," or other bad reason. Those are various ways of saying they assume constant values so they can publish an article, or join some clique that mumbles in an exclusionary inside lingo.

The only good reason for using constant exponents would be that it was true; but in general it is not true. See the papers on "The Fallacy of Fixed Proportions," "What is Economic 'Intensity'," "Quantum Leaps and Ecotones," "Contrasts between Large and Medium-sized Firms," "Falling Property Tax Rates and Rising Concentration" (on Reserve), "Complementation, Scale, and the MNP," "The Fallacy of Petty Incrementalism," "Substitution," and "Saving Labor by Wasting Land." Some people very likely use constant elasticities for the very purpose of guiding their readers away from the points brought out in those readings. Not everyone who writes in the idiom of economics is trying to help or edify his readers: quite a few are hired by lobbyists to addle your brains. Don't be victimized.

While we're on exponents as elasticities, a useful application is with the compound interest function. See the paper on "The n% Rule of Thumb."

4. The Cobb-Douglas Function and its limitations

If € remains constant over a considerable reach, then the production function may be written as an exponential function, with € as the exponent. This is the technique used in the "Cobb-Douglas Function," and many derived theorems.

If there are two variable inputs, X and Y, and both may vary, then the Cobb-Douglas function looks like (13):

$$P = kX^{\alpha}Y^{\beta} \quad (13)$$

When a firm has achieved constant returns to scale, it may be shown (and is intuitively obvious) that $\alpha + \beta = 1$.³ This is useful in showing that when $\alpha = 1$ (constant returns to X, max AP of X), then $\beta = 0$ (zero marginal returns to Y). Cf. #2, above; and see the papers, "Wasting Land by Saving Labor," and "Euler's Theorem."

(13) has a feature that many find simplifying, it is "linear in the logs." Take the log of both sides, and you get (14):

$$\ln P = \ln k + \alpha \ln X + \beta \ln Y \quad (14)$$

I am not sure what is so attractive and useful about that, but here is one possible reason. Holding Y constant, and differentiating (14) w.r.t. X, we get:

$$P'/P = \alpha/X \quad (15)$$

Solving for P':

$$P' = \alpha \times P/X \quad (16)$$

We already knew that anyway, from (5). (P' is MP; P/X is AP; and α is €.) Still, it is good when "all paths lead home," because inconsistent results ring alarm bells and force us to drop what we are doing until we find the error. If (14) turns you on, be

³If they summed to more than one it would mean you could raise your inputs, in their present ratio, by 1%, and thereby raise output by more than 1% - a prospect so delightful that you'd continue expanding until you got through this stage of increasing returns to scale.

my guest. However, there are reasons I do not pursue it as much as some other economists do.

Cobb-Douglas is fraught with peril, because ϵ changes its value when one varies the ratio of X to Y. Many analysts use it, nevertheless, on the premise that the exponents may be kept constant by adding X and Y in the same proportions. It is doubtful, though, if firms actually expand that way: every germane data source shows factor proportions changing with scale. See the papers cited in the second paragraph after (6), above.

In addition, even if the values of ϵ were to remain constant over a long reach, the arc- ϵ is different from the value of ϵ at a point.

You should know that Cobb-Douglas exists, and that some theorists love to use it. Some abuse it. For some, it is a another toy for the sandbox - yes, if you haven't noticed already, some academicians get lost playing little useless games.

For some, the sand is handy to throw in the eyes of people they are bamboozling. For some, it is a useful tool. If your math is well-practiced, and you can temper mathematical insight with practical judgement, Cobb-Douglas affords some useful insights. Just don't get carried away and let it substitute for reality. In this course I make little use of Cobb-Douglas, except to illustrate Euler's Theorem. See paper on "Euler's Theorem."

5. Geometric Analogy between finding MP from curve of AP, and finding MR from curve of AR

The geometric relationship of MP to AP is same as that of MR (Marginal Revenue) to AR (Average Revenue or Price) in price theory, a more familiar topic to most students of economics. However, elasticity of demand is defined in a way that is not analogous to elasticity of production, so that the geometric analogy does not translate into an algebraic analogy. The purpose of this section is to show how to fit the algebra of production to the geometry.

$$\text{As to demand, } MR = AR(1 - 1/\epsilon) \quad (17)$$

$$\text{As to production, } MP = AP \times \epsilon \quad (5, \text{ repeated})$$

A. The "slice and slab" method of finding MP

i. The geometrical picture

Draw a curve of AP, of negative slope. Select any point on the curve; call it AP_1 . It determines a rectangle whose sides are the coordinates of the point. Draw it in. The area of the rectangle is the total product, P. Now select another point, quite close, downwards to the right; call it AP_2 . Draw in its rectangle, too. The change in P is the change in the areas of the rectangles. The math convention is to denote such a finite change as " ΔP ". (P' is conventionally used as an abbreviation for the derivative, or instantaneous rate of change.)

Compare the rectangles. Most of their areas are in common (overlapping), but #2 contains a vertical slice on the right side, lacking from #1; and #1 contains a horizontal "slab" on top, lacking from #2. ΔP is the slice less the slab. For a positive ΔP , the slice must be greater than the slab. P is a max when $\Delta P = 0$, and the slice equals the slab.

The value of the slice = AP, where $\Delta X = 1$. The value of the slab is $X \times \Delta y$ (where X is on the abscissa, and "y" is a generic indicator for the ordinate). The trick is finding the value of Δy . Three methods follow, the first being a simple numerical example.

ii. A numerical example

You can plant ten fruit trees per acre, and each will yield 400# of salable fruit. Or, you can plant 11 per acre, crowding the trees, and each will yield 370#. What is the marginal product of the 11th stem?

In this case, the slice is 370#, and the slab is 10×30 or 300#, so the MP is 70#: the slice less the slab. **BEWARE!** The MP is not the 370# yield that is physically produced by the 11th tree. Do not consider the 11th tree just in isolation!⁴ To identify the MP with the yield of the 11th tree is to miss the

⁴In exams, I may trick the unwary by luring them into this error - don't let me get away with it at your expense.

whole point of what MP means. Remember, MP is a systems concept. You have to consider the total effect on the system.

Confirm this result by figuring the two total products. With 10 stems @ \$400, $P_1 = \$4,000$; with 11 stems @ \$370, $P_2 = \$4070$. P_2 less $P_1 = \$70$.

Notice that in this example, the abstract areas on the graph correspond with physical realities: things we can see, touch, and count. There is no mystery; it's common sense. The idea of Managerial Economics is to convert the abstract principles of theory into real things that are concrete and comprehensible.⁵

In Micro Theory you learned price theory, probably better than you learned production theory. In price theory you learned why Marginal Revenue (MR) is less than Average Revenue (AR) when the demand curve has a negative slope: you sell more, but make less on each item otherwise sold at the original higher price. Marginal Revenue is the new sales less the loss on each old sale.

Marginal Product is the same idea, but here it is more trees bearing, and you get less output from each tree.

iii. Reasoning from €

⁵Until you do so, theory is not much use. It may not even be faithworthy. There are lots of fakes and bluffs out there: they manipulate arcane symbols solemnly and intimidatingly, but fail the test of applying their results to anything real. Distrust sham and mumbo-jumbo, even if someone calls it "rigor."

The "slab" must equal the difference of AP and MP:

$$AP + X\Delta y = MP \quad (18)$$

Therefore,

$$X\Delta y = MP - AP = AP(\epsilon - 1) \quad (19)$$

In Stage II, Δy is negative, so the positive numerical value of $X\Delta y$ is:

$$-X\Delta y = |X\Delta y| = AP - MP = AP(1 - \epsilon) \quad (20)$$

When $\epsilon = 1$, the slab = 0, and $AP = MP$. This is the beginning of Stage II, when AP is maxed. This is also where the AP curve remains flat-topped as X grows, so $\Delta P/P = \Delta X/X$. That is, a 5% rise of X means a 5% rise of P, and so on. This is a reach wherein returns to X are constant. If it continues for any substantial change in X, we could call it a "Stage" of Constant Returns. It would fall between what are conventionally called "Stage I" (increasing returns) and "Stage II" (diminishing returns).

As you move to the right through Stage II, the slab gets wider, and may get deeper too (depending on the slope of the AP curve), and ϵ moves down toward zero. When ϵ finally reaches zero, the slab equals AP, and $MP = 0$.

iv. Algebraic generalization

Here, to find the change in y , we fall back on the rules of calculus. (For those without calculus, sorry, but I need this rule!) This means we stop calling the change " Δy ", and start calling it " y' ". y' is not self-evident because y is not self-explanatory, not a single-valued variable. Rather, $y = P/X$, where X is a variable measured on the abscissa.

$$y' = d/dx[P/X] = [XP' - X'P]/X^2 = P'/X - P/X^2 \quad (21)$$

(remembering that $X' = 1$)

$$Xy' = P' - P/X = MP - AP \quad (22)$$

Solving (22) for MP,

$$MP = AP + Xy' \quad (23)$$

AP is the slice, and Xy' is the slab. So, MP = the slice less the slab (recalling that y' is negative after Stage I).

Geometrically, this is the same way we find MR from AR in demand analysis. However, (23) is consistent with $MP = AP \times \epsilon$, whereas $MR = AR [1 - 1/\epsilon]$.⁶

B. Finding MP by the method of fractional changes

Refer to the rectangles you drew in part "A". They represent the product, P. Let "y" represent the ordinate, as before. Then $P = Xy$. The growth of P is the growth of Xy .

There is a calculus product rule for this:

$$P' = yX' + Xy' \quad (24)$$

yX' is the slice; Xy' is the slab. The calculus rule jibes with the slice and slab approach.

It is simplifying and therefore useful to put (24) into terms of fractional changes. Since $y = P/X$, and $X = P/y$, we may substitute those into (24) and rewrite it:

$$P' = PX'/X + Py'/y = P[X'/X + y'/y] \quad (25)$$

(25) is the same as (18) but with Δ replaced by derivatives. As an exercise, show that the equations are the same - you have to translate AP into P/X , etc., and remember that $X' = 1$. We found (18) by a different method, yet it is consistent: good sign!

⁶ ϵ of demand is defined with Q' on top, where Q is on the abscissa. ϵ of production is defined with P' on top, where P is the product of ordinate and abscissa. Naturally, the algebra works out differently.

For a simple, useful, symmetrical and mnemonic result, divide both sides of (25) by P:

$$P'/P = X'/X + y'/y \quad (26)$$

(26) says the fractional growth of P equals the sum of the fractional changes in its two factors (X and y). Remember, though, that in Stage II, where the AP is falling, $y' < 0$. In this case a "sum" means you subtract $|y'/y|$.

(24)-(26) are compatible with (18). That means we could have derived (26) from (18). Let's do it. (18) says that $P' = P/X + Xy'$. (P/X is the slice, and Xy' is the slab.) Show that the right side leads to (25).

$$P/X + Xy' = P[1/X + (X/P)y'] = P[1/X + y'/(P/X)] \quad (27)$$

Recall that $X' = 1$, and $P/X = y$, so:

$$P[1/X + y'/(P/X)] = P[X'/X + y'/y] \quad (28)$$

Q.E.D.

(28) shows that the fractional method and the "slice less slab" method can be viewed as two different ways of seeing the same point, or saying the same thing. Truth has many faces. Now we see it one way, now another, but if what we have is really Truth, the different viewpoints are mutually translatable.

You can fool around with (26) and show that it reduces to what looks like a tautology: $P' = P'$. That does not show it is empty, however. Rather, it shows it is consistent with other ways of making the same point. It is when they are not consistent that there is an error somewhere.

C. Discrete fractional changes (quantum leaps)

Test (26) with some numerical examples. Start with $X=100$ and $y=100$, and $P=10,000$. Does 99×101 also = 10,000? Not quite: it's 9,999. Try 95×105 : that's 9975. Still close

enough for practical purposes, but something is not quite right.

What's wrong? Remember, we began with a calculus rule. Calculus is a device for showing how such approximations approach absolute precision as the changes in the independent variable approach zero. Otherwise they are a shade off. This is where the slice and slab method is superior: it does not depend on calculus.

A shade of difference is not enough to worry us in the brawl and rush of the management world, with its many rough measures and hunches. Now, however, try 50×150 . This = 7500. Whoa, Nelly! Now we have more than a shade of difference. Try 0 times 200 and we have a disaster.

Here is how to handle discrete jumps. Forget the calculus. Take a generic rectangle with B =Base, H =Height, and A =Area.

$$A = BH \quad (29)$$

Define a as $\Delta A/A$, b as $\Delta B/B$, and h as $\Delta H/H$. Then:

$$A(1+a) = B(1+b) \times H(1+h) \quad (30)$$

Divide equation (30) by (29), and:

$$1+a = (1+b) \times (1+h) = 1 + b + h + bh$$

$$a = b + h + bh \quad (31)$$

This is the same as (26), except for the bh . Now if we go from 100×100 to 50×150 , we get:

$$a = -.5 + .5 - .25 = -.25$$

That is a drop of 25%.

If we go to 0×200 we get $a = -1 + 1 - 1 = -1$

That is a drop of 100%.

Note that when the changes are equal and opposite, b and h wash out, leaving us with bh .

To maximize A , you want a to be zero. When $a=0$:

$$b = -h(1+b)$$

$$h = -b/[1+b] \quad (32)$$

When b is very small, $1+b \rightarrow 1$, and you get the simple calculus rule again.

6. Dissipating Rent by Wasting Capital and Work

A. Dissipating rent

See the paper "Saving Labor by Wasting Land." You can also save land by wasting labor. Such "saving," however, may be carried into Stage III, where the MP of work is negative. Think what that means: you actually produce less per acre by applying more work per acre. You're wasting both work and land, at the same time.

This can happen where lands are unfenced, as on an open range. The open range, to be sure, was a transient episode in the 19th Century, and much overblown in horse operas. Open fisheries, however, are quite common up to the present, and are only now being phased out in national waters. Look at each fishing boat and crew as the unit of the variable input applied to a fixed fishery resource. So long as the AP per boat exceeds the AC per boat, and the boats are independent, more boats will come. They will keep coming until the AP is forced down to the AC. This phenomenon ends up destroying the entire rent of the fishery: the cost of fishing expands to equal the gains, with no surplus.

The crowding that results has been given two names, at least: "The Dissipation of Rent"; and "The Tragedy of the Commons." Ask yourself how it got those names, and how they relate to the relationship of the slice and the slab, as discussed above in Section #5,A. I am not going to explain this in detail: you can now figure it out, and should do so. The individual shipowner is motivated solely by the slice, and ignores the slab. A major shipowner with a monopoly of the fishery would consider both. I will not draw you a picture now, but say this: **YOU SHOULD UNDERSTAND THE FOREGOING SENTENCES, AND**

BE ABLE TO EXPLAIN THEM ON AN EXAMINATION. It's a matter of translating the theory into a practical situation.

A firm that owns the entire fishery, and can exclude interlopers, would manage it differently. It would consider the "slab," not just the slice. Such management is traditionally called "rationalization."

B. Tenure vs. market monopoly

Tenure over resources, with resulting downsizing of the labor force applied, can be justified economically. Now consider an extension of the same idea. Suppose there is just one fishery, and the firm that gets it gets not just tenure, but a market monopoly. In the market monopoly, it controls quantity and price. That means its Marginal Revenue is less than its Average Revenue.

Market monopoly is something like having tenure over a market. Geometrically, this is because Average Revenue is a slice, while Marginal Revenue is a slice less a slab. Economic theory tells us that monopoly is anti-social, and sellers should ideally be motivated just by the slice (price of additional sales), and not by the slab (lower price on existing sales). Thus, orthodox theory says that tenure is socially good, while monopoly is socially bad. As a test of your understanding, explain why that is true. I am not going to do it for you here: you should now be able to do it yourself.

C. A Bias among Economists

The ordinary neo-classical economist these days is a conservative, property-oriented person who loves to make point "A", above. In doing so, most of them overstate it. They favor subjecting all natural resources to private tenure, then leaving everything else to market forces. They shut their eyes to the fact that private owners of resources often underuse them, laying off workers and aiming at maximizing the AP of labor. Thus, they commit the fallacy of Saving Labor by Wasting Land - see paper of the same name. Saving Labor by Wasting Land leads us to the dissipation of rent by another route: underuse. Underuse is as bad as overuse, and in many ways worse. Underuse throws people out of work.

Just why owners given tenure over natural resources tend to underuse them is a big subject, that we deal with elsewhere. Suffice it to say here that the usual treatment by economists these days is unbalanced, in my opinion. I am telling you about the "Dissipation of Rent" not because I think it is our major problem, but because it is a good teaching device to help you understand the meaning of marginal productivity. Our major problem these days is people who overstate the case for privatizing resources. That, however, is a topic too big to pursue here.

7. Finding and Maxing the Bottom Line (Rent)

A. Why the bottom line is rent, not profit

I have mentioned elsewhere that when you equate Marginal Product and Marginal Cost you are maximizing Rent. Rent is the return to the fixed factor. It is not the same as "profit." Profit is a word that belongs in the analysis of personal distribution. It is maximized by owning all the inputs in sight. In Managerial Economics we are concerned with putting resources to the best use. To do so we impute returns to the resources as such, regardless of who owns them.

B. Maximizing Residual Rent (RR)

$$RR = P - C = X(P/X - C/X) = X(AP - AC) \quad (33)$$

$$\text{Let } y = AP$$

$$R' = X'(y - AC) + Xy' \quad (34)$$

$$R = \max \text{ when } R' = 0$$

$$X'(y - AC) = -Xy' \quad (35)$$

Substituting from (22):

$$X'(y - C/X) = P/X - P' \quad (36)$$

Recall that $X' = 1$, and $y = P/X$

$$P/X - AC = P/X - P' \quad (37)$$

$$P' = AC = MC \quad (38)$$

Thus, expectedly, R is a max when $P' = MC$. This point is graphically obvious, but it is good to have some confirming algebra.

As we have seen, there are other methods of approaching this proof. By now, however, we should have confidence in the various methods and their consistency.

3 stages of production

NB ---> THIS IS A LECTURE OUTLINE, WITHOUT FULL TREATMENT OF
POINTS LISTED

1. Values of ϵ in the 3 stages, and at the critical points between them.
2. Reasons why Stage II is most common.
3. Stages I and III do occur, however, and need to be treated. Ordinary neo-classically trained economists tend to neglect them.

a. Open access to land leads to Stage III proportions. Examples: open range; common pools of petroleum, gas, water; wild fish and game; parks; highways; property rights based on use or capture;

A trickier case is damage functions from pollution. Here, damage is treated as the product, everything is backwards, and it is desirable to concentrate pollutants where they may do the least damage and may actually become useful by-products.

"Tragedy of the Commons" vs. "The Magic of Property turns Sand into Gold." Crowding and the dissipation of rent. Maldistribution of population caused by rent as a magnet. Unregulated airlines and the rush-hour crush. Radio interference. In such cases, congestion brings equilibrium, but not an optimal one.

Subtle cases of rent dissipation, a step removed. Exploration for minerals before leasing on the OCS and state lands. Mining Law of 1872 on uplands of Federal domain. Free mining rights in British Columbia. Heavy local taxation to serve immigrants (Marshall's "onerous" taxation). Social dividends in Alaska and Alberta. Machine politics in big cities. Cross-subsidies.

b. Stage I proportions occur where lack of demand limits scale. Examples of public works, mass transit, and distributive networks of public utilities, especially where they are oversized today in expectation of future higher demand. Case for

"marginal-cost pricing" (the seller is a price-maker, and sets $P = MC$).

4. Property rights: a partial solution, creating new problems
Man has invented property to substitute for Nature's tooth and claw. But man has overdone it.

Distributive injustice.

Institutional obstacles to full economic use of superior or "rentable" land.

The kind of market failure called "land speculation."

Cartel prorates putting rentable land on ice. Market entry prorated by landholdings, overmotivating land acquisition. "Rent-seeking" in various forms, e.g. appropriating water.

Tax rewards for land speculation vs. tax penalties for land use.

"Land Banking" by governments and large private holders.

Property taxes based on the market price of land used to abate those problems. Since 1978 in California, however, such taxes are held down to very low rates.

5. Magnetism of open-access rents vs. repulsion of cartelized rents results in extreme overuse of former relative to extreme underuse of latter. T.N. Carver and "the congested frontier" problem.

A.

	<u>CP</u>	<u>TR</u>	<u>MA</u>	<u>NR</u>	<u>MNR</u>
1	30	30	30	30 $30 - 15 = 15$	15
2	70	140	110	140 $140 - 30 = 110$	$110 - \frac{15}{2} = 92.5$
3	60	180	40	180 $180 - 45 = 135$	$40 - \frac{15}{3} = 35$
4	50	200	20	$200 - 60 = 140$	$20 - 15 = 5$
5	40	200	0	$200 - 75 = 125$	$0 - 15 = -15$

B.

4

C.

NR

D

3, bus $MC = 15 + 7 = 22$

E.

4

Midterm, Economics 001, October 31, 2003

Answer the essay question in your blue book, using about 20 minutes. Use scantron for the multiple choice questions. Place your scantron carefully inside your blue book so it will not fall out - use a paper clip if you can. Remember to put your name and I.D. on both. Also, put the name of your T.A., and the Section you go to, on the blue book.

ESSAY QUESTION.

You own and manage a barber shop in a good location, with several chairs. Experience teaches you that the revenue per barber per hour will change as you add more barbers, as follows: 1- \$30; 2- \$70; 3- \$60; 4- \$50; 5- \$40.

A. Use a table and show the Total Revenue (TR, or TP), and the Marginal Revenue (MR, or MP) for each number of barbers.

B. Each barber costs you \$15 an hour. How many barbers should you hire, to maximize your net revenue as owner and manager?

C. Add another column showing the net revenue (NR, or NP) for each number of barbers.

D. EXTRA CREDIT. You are hit with a bouquet of taxes and charges on each barber: workmen's comp, payroll tax, medical insurance, etc. They add up to \$7 per barber-hour. Now how many barbers should you hire, to maximize your net revenue?

E. EXTRA CREDIT. You are hit with a property tax, a fixed annual sum figured as a small percentage of the market value of your shop and its site. Now how many barbers should you hire?

SCANTRON QUESTIONS, MULTIPLE CHOICE. (NOTE: You may choose any number from zero up to all. If you choose "zero," it is not necessary to call it "none of the above.")

1. Which of these "terms of art" are "flow values"?

- ✓ a. imputed income
- b. interest rate
- ✓ c. wages
- d. debt
- ✓ e. deficit

2. Which kinds of taxes are levied (or imposed) on the base of a "balance sheet" value?

- ✓ a. property tax
- b. income tax
- ✓ c. estate (inheritance) tax

- d. gasoline tax
 - e. sales tax
3. What kind of income is the rise in value of a house, when the house is not sold?
- a. ordinary
 - b. imputed
 - c. equity withdrawal
 - ✓ d. unrealized capital gain
 - e. all of the above
 - f. not income at all
4. How can you withdraw equity from a house without paying taxes?
- a. scrap it
 - b. pump out the water pipes
 - c. insure it and torch it
 - ✓ d. sell it
 - ✓ e. pledge it for a loan
5. Why do we try to measure all values in dollars?
- a. to show patriotism
 - b. economists are money-mad materialists
 - c. the \$ is the world's soundest currency
 - ✓ d. for commensurability
 - e. to exclude trivial values like cooking and housework
 - f. to help banks lend
6. What are some Mercantilist policies
- ✓ a. preservation of traditional status
 - ✓ b. using government for private gain
 - ✓ c. rigging terms of trade to favor the home nation
 - ✓ d. militarism
 - e. high incomes for all
7. Which school of economic thought most favors the interests of young people entering the labor market?
- ✓ a. Physiocrats, by untaxing trade and labor and fructifying idle lands
 - b. Mercantilists, by acquiring more Lebensraum and helping surplus workers emigrate
 - c. Malthusians, by checking growth of the work force
 - d. Adam Smith, by fostering trade, the market, specialization, and capital formation
 - ✓ e. Ricardo, by lowering food prices
8. How did the Physiocrats reconcile and fuse policies that today are considered "left" and "right"?
- a. by eliminating waste in government, to spend more on welfare

- ✓ b. by untaxing labor, production, trade, and capital formation, while raising taxes on idle land
- c. by freeing internal trade while protecting the home market from imports
- d. by admitting cheap foodstuffs into France
- e. by promoting democracy, education, and free thought

9. How does one distinguish the produit net (rent) from income?

- ✓ a. they are the same
- ✓ b. rent excludes revenues imputable to the owner's labor and capital
- ✓ c. income excludes interest on mortgages
- d. produit net is just French, and means nothing in English
- e. rent is net of interest on capital, but not of depreciation of capital

10. Madam Chiang Kai-shek died last week, aged 105. She was one of three remarkable Soong sisters, of whom it was said "One loved power, one loved money, and one loved China." The one who loved China had married Sun Yat-sen. Sun had revived the policies of Wang an-Shih, who had anticipated the Physiocrats. Where and by whom were Sun's policies applied in the 20th Century?

- ✓ a. China, by Mao Tse-tung
- ✓ b. Taiwan, by Chiang Kai-Shek
- c. Japan, by the Meiji Restoration
- d. The Philippines, under American tutelage
- e. Viet Nam, under Ho chi Min

11. What barriers to augmenting the wealth of nations did Adam Smith overlook?

- ✓ a. mankind can create capital, but not land
- ✓ b. lower interest rates may ~~land~~ ^{raise} rents, which thus intercept the share going to workers
- ✓ c. capital may substitute for labor, as in the enclosure movement
- ✓ d. sovereign consumers may stupidly buy the wrong things
- ✓ e. capitalists may amass most of the wealth in a few hands
- f. All of the above

12. Why did the birth rate in England fall after Malthus wrote?

- a. The Black Death (bubonic plague) felled half the population
- b. The Great London Fire wiped out trade, finance, and specialization
- c. Wars with France, Holland and Spain wiped out the soldiery
- d. feminists popularized The Pill, condoms, diaphragms, sponges, etc. — ?
- e. the churches successfully preached abstinence

13. How can one distinguish land value from building value, once a lot is improved?

- ✓ a. land value is what remains after a good fire
- b. you can't
- c. you subtract the original cost of the building from the value of the whole

Fri, Nov. 14 Craig

Utopians

Good is good?

Mkt. failure

Alienation

- from the product
- " relative control of work (McJob)

Solutions

- Unions ("works well in the west")
- Public ownership
- Smaller units
- Share profits
- Worker ownership
- Self-sufficient communities.

Owen

N. Lank

Coops Mount. Wards grew from one
Trade Union - led to Labor Party

St. - Simon

Righteousness

No priv. property

Failed to implement

Fourier

Small communities

Proudhon

Anarchist.

Small communities

Russia

Narodniks 1840-80

Chernyshevski

Employee benefits

Tolstoy

Religious coop. farms

Modern applications

Schumacher. Approp. Tech. "Available" Tech.
London-based Internat. Tech. Dev. Group (ITDG)
Japan TQM, Total Qual. Mgmt

Gramscian Banks

TQM, Deming. "Worker knows best"

Chrysler, T.I., Fed Ex

Mon., Nov. 17.

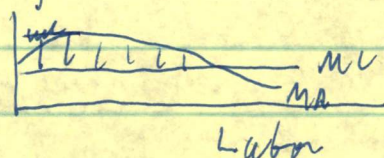
A. Mill, loose ends

1. Land-saving tech.

- Self-wring for septic tanks
- Bikes, mass transit, smaller cars, cabs in NY
- Demand mgmt - use less water
- Fork lifts
- Billiards for golf.
- Thermostats
- Plastic for ivory

2. Taxing rent.

a. Defining rent



b. Prop. tax based on mkt. value
Constant wrt labor

c. Inc Tax on land inc.

(E.g. net proceeds taxes)

(E.g. early U.S. inc tax, 1913-20)

Not const., but $\rightarrow 0$ as $MNR \rightarrow 0$.

Deduct cost of labor.

B. Utopians

- In U.S. history
- Define Luddite

2
C. Wallace
Leading pioneer
& Evolutionist. but an Overwrite re hered vs.
environment.

D. H. George

Review Fwi.

Utopians.

Luddism

Alienation

Dickensian

Tory (defender of status quo)

Nature vs. nurture (hered. vs. env.)

Owen

New Lanark

Coops

Religious colonies

Dignity of labor (St. - Simon)

Mill

Feminist

Civil Libertarian

Politician

Distrib. indep. of laws of prodn

Redistrib. ~~tax~~ w/o misallocn. - via. taxn.

Reform from top down - cautious reform

Progress thru K known, not gross growth

Factor substn - modify products & processes

Small farms, business. E. F. Schumacher.

Wallace

Natural selection (not survival of the fittest)

Opposed genetic elitists - supported others

(Galton, Huxley, Spencer, Sumner, ~~Chamberlain~~,
Hitler, Huxley, ~~Herbert~~ Huxley + Murray)

Redistrib. wealth every generation

T. Jefferson

Nationalize land by purchase

George

2 total, ~~was~~ incautious reformers: George & Marx.

Appendix I: Land-saving technologies (refer to John Stuart Mill, point #8).

Technology subbing labor for land, via adapting technology

1. Frequent replacement
2. Maintaining and rehabbing old capital (somewhat at odds with #1 - reconcile).
3. Packing
4. Cleanliness
 - a. Picking up trash
 - b. Cutting pollution
 - c. Cutting emissions by maintaining engine efficiency
5. Sewers for septic tanks
6. Organic farming
7. Demand management
 - a. In energy, "negawatts for megawatts"
 - b. In water, timing instead of bigger reservoirs; full use of local sources, instead of messing up the Delta
- ✓ 8. Norton Utilities to save space on hard disk; defragging
9. High-rise buildings
10. Forklift for stacking, using 3-d
11. High-intensity farming
 - a. Organic methods
 - b. Biological pest controls
 - c. Choosing crops like fruits, nuts, and vegetables
 - d. Ideas from Lappé, Susan George, David Pimentel, et al.
12. Using smaller machines
13. Shipping cattle by rail instead of driving them, and droving hogs.
- ✓ 14. Chess, billiards, pingpong, hiking, jogging, tennis, basketball, soccer, even football, in lieu of golf, polo, foxhunting, horse-racing, power-boating, big-game hunting, etc.
- ✓ 15. Computers for storing data.
16. Roger Bezdek
17. Smaller cars
18. Maintaining older cars and using them; then scrapping them quickly.
- ✓ 19. Storing food; also preserving, distributing it.

- ✓ 20. Synthetic fibers.
- ✓ 21. Appropriate technology; soft path; low-tech; etc.
- 22. Small loans, close to home office, vs. massive world bank loans for monuments, vast reservoirs, etc.
- ✓ 23. Use of cabs and mass transit, e.g. in NYC.
- 24. Email
- ✓ 25. Renewing old brownfields instead of new greenfields, thus salvaging old infrastructure.
- 26. Traffic control, in lieu of new lanes.
- 27. Subbing paper money for gold; then checking accts., then electronic transfers.
- ✓ 28. Refining petroleum: more gasoline per bbl of crude.
- ✓ 29. Wood processing: pulping, chipping, using more of the tree, using younger trees.
- 30. Using fuels other than wood.
- Using renewable sources of energy: wind, water, solar, tidal, adiabatic - and back to wood, but in fastgrowing forms like hemp, and kenaf.
- 31. Using by-products,
 - a. Instead of slaughtering whole buffalo to get a little meat, as hunters of the Buffalo Bill era did.
 - b. Using pot liquor as soup stock.
- ✓ 32. Using vegetable products for animal products, e.g. tofu.
- 33. Using mechanical traction for animal traction.
- ✓ 34. Using manure for fertilizer in place, instead of polluting groundwater basins.
- ✓ 35. Poultry for beef.
- 36. Finding uses for noxious weeds, e.g. the rank reeds in the Sta. Ana River.
- 37. Applying and controlling natural products sparingly, as needed.
 - a. Thermostats
 - b. Water delivery systems: spitters, drippers, emitters.
- 38. Raising turnover speed, moving materials through the pipeline faster.
- 39. Compacting settlement.
- 40. Regional specialization, linked by transportation: e.g. grow bananas in Guatemala rather than Alberta.
- 41. Greenhouses.

- 42. Aircraft
- 43. Using materials with less content of scarce resources, esp. energy.
 - Plastic piano keys for ivory.
 - Plastics for metals, woods.
 - Alloys
 - Bamboo scaffolding
- 44. Managing fisheries to optimize catch, preserve stock
- 45. Air traffic control

46. Smaller planes, more frequent service.

47. Round-the-clock use of valuable space, roadways, etc. Diversified demand. Smoothing out peaks and valleys.

48. New opportunities arise for higher volume uses of land. Farmers may shift from cattle to small grains to dairy to vines to labor-intensive produce, as some of them have in California. As landholders intensify, elasticity of production () rises and labor's share of total output rises even as net gains per acre also rise.

But the landholder who chooses to go high volume and low unit gain is choosing a peck of trouble, too. He may not want to leave the old quiet life behind. But that "peck of trouble" is a form of labor.

49. In a well organized society new frontiers arise from the effects of social synergy, mainly in cities. Urban lands have shown an enormous capacity to absorb labor in manufacturing, trade and services.

✓ 50. In an intellectual society demands develop for much more labor-using or "downstream" (near the consumer) activities like entertainment, medicine and learning. Feeding hogs isn't everything, (even if some of us enjoy getting back to it after a time indoors at the office).

51. Sanford Rose "The Far-reaching Consequences of High-priced Oil," Fortune, March 1974, pp. 106-12, 191-96.

Shows how producers economize on a resource-based product when its price rises.

52. Modern running shoes instead of leather boots.

APPENDIX II;

THEORIES OF PROPERTY: WHAT DO WE OWN?

(For class use, Mason Gaffney, adapted from Robert Scrofani)

"Though the earth ... is common to all men, yet every man has a property in his own person; this nobody has a right to but himself. ... whatever he removes out of the state of nature and mixes with his labor he joins to it something that is his own, thereby making it his property. ... and by his labor has annexed something to it that now excludes the common right of other men ... AT LEAST WHEN THERE IS ENOUGH AND AS GOOD LEFT IN COMMON FOR OTHERS." -- John Locke, Essay on Civil Government.

The part in caps, above, is called "The Lockean Proviso." Locke did not tell us what to do where there is NOT "enough and as good left in common for others" - and of course, that is the real problem. Locke left it for us. What is your opinion?

Clueless? Below are some rival theories of distribution, hence of property, to get you started.

Dead certain, and not confused? Then maybe you just don't understand how hard it is to defend your theory against the others. Give it a try.

1. The Functional Theory: "The product belongs to the producer."

Posers:

a. How divide shares of a joint product? (Economists worked out the theory of marginal productivity to answer this poser.)

b. How about land, which was never produced by man?

c. What forms capital: labor, or saving? who is the "producer" of capital to whom the product rightly belongs?

2. The Egalitarian Theory: "Equal shares for all."

In philosophy, this is most often applied to land. In wartime, with rationing, it has been applied to key commodities like food and fuel, but not to land or housing.

3. The Power Theory, or *Lex fortioris*: "Let him take who has the power, and let him keep who can."

See John Wayne in Red River for this theory in the raw. The rationale, if anyone bothers, is that survival of the most predatory and acquisitive, "red in tooth and claw," is good for the future of the race.

Posers:

a. Are the palace machinations of courtiers, bribing land office agents, and lobbying Congress, values with survival value for the human race?

b. Is there any basis here for inciting survival activities like labor and saving? Is acquisitiveness the same as creativity, thrift, and productivity?

4. The Priority Theory: "First Come, First Served."

Alternatively, "First in Time, First in Right." "First" often applies to "use," not just occupation, fencing, or claim. This is how water claims are decided in most of the 17 western states, for example.

Posers:

a. Must we give it all back to the Indians? If so, which Indians? Must the Normans give it all back to the Saxons, and the Saxons to the Celts, etc.? How much Indian blood makes an "Indian"? How shall ancestry be proven?

b. Should blacks be penalized because their ancestors were held in bondage while the public domain was being privatized, for whites only? Should Americans of oriental ancestry be penalized today because their ancestors were prevented, by force or law, from owning land? Should Americans of Hispanic ancestry be penalized today because their ancestors could not speak English, or did not understand Anglo law, or lacked political influence in Sacramento and Washington? Should any American today be penalized because his ancestor was a missionary or a soldier, overseas serving his church or country, perhaps being killed, while the ancestors of others stayed at home and acquired public land for themselves?

C. Is it good economics to reward premature use of land, water, or minerals, to lay claim to its future value?

5. The Purchase Theory: "purchasers are innocent of previous wrongs; bygones are bygones; purchase launders all titles."

Posers:

a. If "fences" are guilty of conniving at crime in commodities, how are purchasers of stolen land "innocent"?

b. If "bygones are bygones," need we honor any claim to property? Where is the fairness and symmetry in this theory?

c. California's "Proposition 13" amendment applies a higher tax to the newer, or more "innocent," buyers of land, than to old owners. (Hence it is called the "welcome, Stranger!" law.) Can we square these apparently contradictory notions of "innocence."

6. The Discovery Theory: "whoever finds something, it is his. 'Finders keepers, losers weepers,' as children say."

Rationale: discovery takes work and risks capital, therefore it is a form of production.

Posers:

a. Some things are cheap and easy to find, others are hard and expensive. Should any difference be acknowledged?

b. If God or Nature hadn't put it there, it never could have been discovered. Should the finder take all the credit?

c. For everything that is found, there is that much less for others to find in the future. That is a form of depletion, a social cost.

d. Corporations bid hundreds of millions of dollars, when they must, to buy exploration rights on "mineral-prone" land. Does that indicate the presence of a value in addition to what is added by the cost of exploration?

e. Wealthy firms and individuals have acquired minerals in nations abroad by bribing local tyrants, and/or by getting help from U.S. armed forces. Where is the "justice"?

7. The Tradition Theory: "when we were born, certain people owned things, and others didn't. The way things were is how they should remain."

Posers:

a. The world is inhabited by succeeding generations. Do older people always have superior rights over younger people? Things never remain as they were. Do the newborn have any rights but what they inherit individually? Is inheritance valid?

8. The Self-validating Theory: "Property is an end in itself, its own voucher, needing no rationale." Also called "The Sanctity of Property" concept.

a. "Sanctity" is a theological concept. Is it appropriate to apply it to property law?

b. Not much "rationale" here: either you buy this or you don't. Do you?

9. The Merit Theory: "Persons of Property are Responsible and Superior. In the Interest of All they should Rule, using the Discretionary Income from Property to Hold and Exercise Power."

Posers:

a. How are the landless protected when persons of property allege that their own peculiar interest is the interest of all? ("what's good for General Motors is good for the country.")

b. What is the evidence that property owners are more meritorious?

c. As aliens buy up our land, does the citizen as such have any rights? (About 2/3 of downtown L.A. is owned by aliens, for example. American corporations, in turn, own large chunks of other nations. Who's in charge here, the WTO?)

10. The Biblical Theory: "The Earth is the Lord's, and the fullness thereof." "The land shall not be sold forever, for the land is mine, and ye are strangers and sojourners with me." (Leviticus, Chap. 25.) This is the "Mosaic Law." Jesus said, "Think not that I am come to destroy the law and the prophets; I come not to destroy, but to fulfill."

Posers:

a. Who represents The Lord on Earth?

b. Who owns property that is not land?

c. what is "Caesar's," that it should be rendered unto him?

11. The Stewardship Theory: "Owners are trustees who hold property for the benefit of all."

Posers:

a. How, specifically, are the owners to behave so as to benefit all?

b. What, specifically, is to make them do so, if they wish to act otherwise?

12. The Communist Theory: "The state owns all the means of production, (maybe in trust for the people, but the track record is not so good)."

Posers:

a. How may state personnel be held to account?

b. How draw the line between "means of production," and individual property? Consider that a residence also produces direct services (imputed income) to its owner-occupants. It is a "means of production," producing shelter from the weather above, and a place to live, stand, sit, sleep, eat, clean up, enjoy commodities, and generally survive and "pursue happiness" in life.

13. The Birthright Theory: "All men are created equal, endowed by their Creator with certain unalienable rights."

Posers:

a. Is one of those rights a pro rata share in the property of the nation? Or the land of the nation?

b. If yes, how should those rights be expressed and implemented?

c. If no, what specific rights are unalienable, or is this fine talk about "life, liberty, and the pursuit of happiness" just hot air? Can you have any life, and "pursue happiness" as well, without any right to a piece of the earth?

14. The Life Cycle Theory: "Property is a store of value that people accumulate for their old age. It spares the young from caring for the elderly. It is a welfare system."

Posers:

- a. Does this apply to young people with large inherited wealth? To middle-aged multi-millionaires?
- b. Is it socially desirable to segregate the young from the old?
- c. Who cares for elderly folks without any property?

15. The Saving Theory: "Property is a store of value to reward saving. Without property, no one would save, and there would be no capital."

Posers:

- a. Does this apply to land, which is not created by saving?
- b. People without property may save to buy property, but there is evidence that people with property save less when their land rises in value. (This is called "the wealth effect.") There is evidence that the worst spendthrifts are heirs and heiresses who never learned the discipline of having to save and conserve.

16. The Financing Theory: Land must be given away to the beneficiaries so they can borrow money on it, the better to use and improve it.

Posers:

- a. How select the lucky beneficiaries? What compensation is there to those who are left out?
- b. Is it socially efficient to allocate capital according to collateral security? How about marginal productivity?
- c. Do we not observe that people are able to borrow to build on leased land, e.g. on the Irvine Co. lands in Orange County, or Indian lands in Palm Springs?
- d. Do we not observe that people who acquire land free, like current crop of Russian "kleptocrats," either waste the money or send it abroad?

17. The Efficient Use Theory: Secure possession (tenure) of land is necessary to make some individual responsible for its wise, economical use, motivated by self-interest. It doesn't matter who owns it, so long as someone does: then let the market take over, for the benefit of all. To avoid disputes over who gets

it, validate and legitimize all existing possessions, however they originated, and however precarious they are now.

Posers:

a. where are justice and equal rights in this theory? If it doesn't matter who is chosen to own it, let's start by giving it all to me - would that be all right?

Is it right, or is it just arbitrary, to wipe out the rights of the landless of today, and all newborn generations? Does this theory evade the issue of who should own property? worse, does it sneak in a tacit premise that the current possessors should be the ones chosen to own it? Why is this better than evicting all the current possessors and replacing them with others chosen at random, or by lottery?

The existing ownership of land goes back to political power exercised in the fairly recent past. The market responds to purchasing power, and when you give away property, you determine who has the purchasing power, as well as who has the collateral security to borrow money. Is it consistent to validate a political distribution of land, while rationalizing it as a market-based system?,

b. what should be done about new forms of property, that are constantly being formed? Examples are pollution rights: should they be based on histories of pollution, as is now seriously proposed? Does this create a motive to pollute now, to establish future rights to pollute? More generally, seeking to acquire future tenures that will yield rents ("rent-seeking") is recognized by economists as a distortion of motivations that warps human activity and investment in uneconomical ways.

c. what should be done about possessory interests or concessions that involve public subsidies, e.g. contracts to get cheap irrigation water from public projects? Should the public subsidy be guaranteed forever, so the current contractor can sell it? (I'm not making this up: it is very seriously proposed.)

d. Should any resources be left with open public access?

e. Considering the record of extreme concentration and poor utilization of land in most

Latin American nations, is the evidence persuasive that unchecked privatization in fact has led and will lead to the highest and best use of land?

f. Is it possible, through some modification of this idea, for the nation to gain the advantages of private tenure, and motivation, without giving up the equal rights of all?

18. The Need Theory: "Just take what you need, and leave the rest."

This "rough-and-ready" frontier theory is vague, but can be made to harmonize with some of the above theories. "what you need" is no more than you can use yourself, so the land and other wealth you take will be well used, as in #17. No one else will need to rent from you, so incomes will be based on your work and improvements - i.e. they will be functional, as in #1. It is egalitarian, since you "leave the rest" for others. It corresponds with standard courteous behavior at a picnic or a party, and has deep roots in social folkways.

19. Other Theories: Can you name and/or articulate more theories not covered above?

Questions for Discussion

-- There are dozens of questions in the text above. Pick any one and give your answer, including of course the reasons for your answer.

Appendix III: Craft-derived English surnames.

English Names Derived from Crafts, Trades, or Positions. Some names of Irish, Scotch, and Welsh origin have doubtless slipped in. French, Spanish, German, Jewish, Italian, Scandinavian, and other ethnic names are omitted; among those, German and Jewish seem to be the richest sources.

Abbott ~ Almoner ~ Appleman ~ Appler ~ Appling ~ Archer ~ Arkwright ~
Arrowsmith ~ Backer ~ Backman ~ Bailey ~ Bakeman ~ Baker ~ Bakester
(Baxter) ~ Banker ~ Bankman ~ Barber ~ Bard ~ Barker ~ Barman ~ Baron ~
Barrow, Barrower ~ Beadle ~ Beeman ~ Beer ~ Bellman ~ Bender ~ Binder ~
Bishop ~ Black (smith?) ~ Blackman ~ Blackwelder ~ Blanchard ~ Bleacher ~
Blocker ~ Bloomer ~ Boatman ~ Bookbinder ~ Booker ~ Bookman ~ Boomer ~
Bower ~ Bowler ~ Bowman ~ Boxer ~ Boxman ~ Brewer ~ Brewster ~ Bricker
~ Bridger ~ Bridgman, Bridgeman ~ Buckman ~ Bunker ~ Butcher ~ Butler ~
Cannon (eer) ~ Cantor ~ Captain ~ Carpenter ~ Carrier ~ Carter ~ Cartwright ~
Carver ~ Chamberlain, -lin ~ Chancellor ~ Chandler ~ Chapman ~ Chevalier ~
Chipman ~ Clark, Clarke, Clerk, Clarkson ~ Cobbler ~ Coleman ~ Collier ~
Cook ~ Cooper ~ Cordwain ~ Cordwright ~ Cornett ~ Coster ~ Costerman ~
Cotter ~ Courier ~ Coward (Cowherd) ~ Coxswain ~ Crapper (really, but the
object's name came from the surname) ~ Croft, Crofter ~ Cropper ~ Currier
~ Cutler ~ Cutter ~ Dancer ~ Deacon ~ Dean ~ Decker ~ Ditcher ~ Docker ~
Draper ~ Drayer ~ Drinker ~ Driver ~ Drucker (printer) ~ Drumm (drummer) ~
Dugger ~ Duke ~ Dyer ~ Earl, Earle, Earley? ~ Faber (fabricator?) ~ Falconer ~
Farmer ~ Farrier, (Farr; Ferry?) ~ Farrower, Farrow ~ Feller ~ Felter ~ Ferrier,
Ferry ~ Fisher ~ Fletcher (Arrowmaker) ~ Flower ~ Foreman ~ Forester,
Forrester ~ Fowler ~ Fuller ~ Gardner (Saxon root), Gardiner (Norman root) ~
Gathercoal ~ Geiger (violinist) ~ Gilder ~ Gleaner ~ Goldman ~ Goldsmith
(Gold, Golden, Gould, ...) ~ Graf ~ Groom ~ Grover (groover?) ~ Harper ~
Harrower ~ Hatter (Irish?) ~ Hatterslea ~ Head ~ Helper ~ Hemmer ~ Henman
~ Herder ~ Hewer ~ Hinman ~ Hooker ~ Hooper ~ Hopper (hop-grower) ~
Hornblower ~ Horner ~ Horsman ~ Houseman ~ Houser ~ Hunter ~ Huntsman
~ Hyndman ~ Joiner ~ King ~ Knight ~ Lackey ~ LeRoy (the king) ~ Lister ~
Loomer, Loomis? ~ Lord ~ Major ~ Mariner, Marriner ~ Marker ~ Mason ~

Master, Masterson ~ Melder ~ Mercer ~ Merchant ~ Messenger ~ Miles
(soldier) ~ Miller ~ Milliner ~ Millman ~ Millwright ~ Miner ~ Mower ~
Naismith (Nailsmith) ~ Naylor (Nailer) ~ Nutter ~ Officer ~ Oliver, Olivier (Fr.
for olive-tree) ~ Packer ~ Page ~ Painter ~ Palmer ~ Pennypacker ~ Picker ~
Pickler ~ Pike (Pikeman) ~ Planer ~ Player ~ Plowman ~ Pollard ~ Pope ~
Popper ~ Porter ~ Post ~ Postman ~ Potter ~ Pricer ~ Priest ~ Principal ~ Pryor
~ Rafter ~ Raker ~ Raper (from Reaper?) ~ Record(er) ~ Rector (Ir.?) ~ Reeve
~ Retter (Retton?) ~ Rider, Ryder ~ Ritter (gm.) ~ Rocker ~ Roper ~ Salter ~
Sawyer ~ Scribe ~ Scribner ~ Sergeant ~ Sexton, (Saxton?) ~ Shafer, Schafer ~
Shaver ~ Shearer ~ Sheller ~ Shepherd, Shephard, Shepard, Shepheard, etc. ~
Sherman (Shearman) ~ Shipman ~ Shoemaker ~ Shoreman ~ Shriver ~
Silversmith (Silver, Silverman, ...) ~ Singer ~ Skinner ~ Slater ~ Slaughter ~
Smith ~ Soaper, Soper ~ Sower ~ Speaker ~ Spicer ~ Spindler ~ Spinner ~
Springer ~ Squire ~ Steedman ~ Steward ~ Stillman ~ Stocker ~ Stockman ~
Stonebreaker ~ Stoneman ~ Stoner ~ Storer ~ Streeter ~ Stringer ~ Swain ~
Tailor, Taylor ~ Tanker ~ Tanner ~ Tarrier ~ Teacher ~ Teller ~ Tennant ~
Thatcher ~ Thrall ~ Thresher ~ Tiler, Tyler ~ Tinker, Tinkerslea, etc. ~ Tipper
~ Trainer, Traynor ~ Trapper ~ Tubman ~ Turner ~ Waggoner ~ Wainwright ~
Walker ~ Waller ~ Ward ~ Warden ~ Warder ~ Warner ~ Waterman ~ Weaver
~ Webster ~ Weller ~ Wellman ~ Wheeler ~ Wheelwright ~ Whipple ~
Whistler ~ Woodman ~ Workman ~ Wright ~ Yeomans

Post mid-term

David Amirhan

Tues. 4P

4PM

12-13

Recommended study questions to prepare for Midterm, Economics 1, October 31, 2003

1.
 - a. Name three ways to organize society
 - b. We use all three methods. Give modern U.S. examples of each.
 - c. What school of thought is associated with a big shift "from status to contract"?
 - d.

2. Name 3 or more policies espoused by The Mercantilists.

3. What social and economic policy preceded Mercantilism in Europe?

4. Was Mercantilism a "good neighbor" policy?

[No. The aim of each Mercantilist was to grow and benefit his own state at the expense of others. In their view, the gains from trade are not mutual - one party only gains what the other loses. It's a jungle out there!]

5. In what three ways would Mercantilists have a nation rig its international trade?

[i. W.r.t. peer and rival nations, rig the terms of trade to favor the home nation: sell dear and buy cheap.

[ii. W.r.t. dependent nations and colonies, cast them as providers of raw materials for home manufacturers. This was the "policy of provision." It is what triggered off the American Revolution.

[iii. W.r.t. the globe (i.e. the sum of all other nations) export more than you import, to build up gold reserves. This side of Mercantilism is "Bullionism."]

6. Did the Mercantilists consistently favor individualism?

Mercantilists had little faith in the free market, but rather in sheltered trading, banking, or landed privileges. In this respect they somewhat resemble the Whig Party of Henry Clay in America, and hence both the Republican and Democratic Parties after the rigged "election" of Hayes as President in 1877 (for former Whigs then controlled both Parties).

7. Were the Mercantilists "hawks" or "doves" in foreign affairs?

Mercantilists gave high priority to military and naval power, to secure lands, and ocean routes, and privileged access to ports. They were constant hawks, inclined to assume that warfare and conflict are the natural human condition.

8. Where did Mercantilists stand on the rights of labor?

Mercantilists championed low wage rates, privatization of common lands, and unequal distribution of wealth and income. They favored the enclosure and privatization of common and church lands, and their engrossment by a handful of royal favorites and Parliamentary leaders. They favored low wage rates to aid exports without having to lower rents, and to use the labor supply fully without raising domestic consumption (which would raise imports).

9. How did the Physiocrats seek constructively to reconcile what today are called "radical" and "conservative" positions on economic policy?
10. Why was there a large landless proletariat in England in 1776, when Smith wrote *The Wealth of Nations*?
11. Did Adam Smith address the cause of labor's problem directly?
12. How did Adam Smith say that the market regulates prices, volume of production, and the incomes of producers, all in the general public interest?
13. Where did Adam Smith stand on free trade?
14. What is "laissez-faire"? Why did Smith borrow a French expression?
15. What is "consumer sovereignty"?
16. What did Adam Smith say about specialization?
17. Was Smith a long-term optimist?
18. What fault did Malthus find in Adam Smith's "Law of Accumulation" of capital, that kept Thomas Malthus from sharing the optimism of Adam Smith?
19. How did Malthus's ideas undercut the demands of labor for a larger share of the pie?
20. How did Malthus's ideas refute Adam Smith's idea of the harmony of economic interests?
21. What advice did Malthus have for the poor, and for the rich?
22. Is India an example of overpopulation, as Heilbroner asserts?
23. Why did the birthrate in England and Europe fall after Malthus wrote?
Give 3 or more reasons, selecting what you consider the most important ones.
24. Why did food supply rise more than Malthus thought possible?
Again, 3 or more reasons.
25. Malthus made many errors, but so do we all. Is there enduring truth in Malthus?
26. Does the current (October, 2003) rash of wildfires in southern California illustrate and support the views of Malthus? Why, or why not?
27. What is "diminishing returns" of more labor applied to fixed land? How does it help explain the growth of rent?
28. Napoleon banned food exports from Europe to England for many years up to 1815. How did that affect the rent of English farmland?
29. What were the English "Corn Laws," 1815-46?

How did they affect the rent of English farmland?

30. What is the extensive “margin of cultivation (or production)”?
- Do hired workers on good land make higher wages for the same work as those on land at or near the margin of cultivation (bad land)?
 - Do products grown on good land (at low cost) sell for less than those grown on bad land (at high cost)?
 - How did higher prices of English “corn” (wheat, to us) affect:
 - The margin of cultivation;
 - Rent on good land;
 - Intensity of use of good land.
31. A grower adds one more “stem” to his one-acre grove of date palms. Why is the marginal product of that stem less than the dates that it bears?
32. What is the “intensive” margin of production?
33. You are given the following AP values for a sequence of workers, from #1 to #5: \$3, \$8, \$12, \$15, \$17. Write them in a column in a table, and calculate the TP and the MP for each number of workers.
34. To raise the demand for labor (and hence wage rates and your income when you leave college), would you adopt policies that focus on raising the MP of labor, or the productivity of labor?
35. How do you find the optimal combination of labor with a fixed “plant” (building and equipment) at a fixed location?
- 36 Explain why the elasticity of production (ϵ) equals MP/AP .
37. If it is worth hiring 10 workers, and $\epsilon > 1$, why is it almost always worth hiring at least one more?
38. What is the value of ϵ at the cusp between Stage I and Stage II? How about the cusp between Stages II and III? Illustrate graphically, using smooth curves.

39. Using your smooth curves showing MP and AP, indicate the area representing the TP. There are two methods: use either one. If you are ambitious, show both.
40. Using the same curves, indicate the area showing the net product. Note, you'll now need a third curve showing the Marginal Cost of labor. Also note, this curve will also show the Average Cost, since the cost per worker is constant. This curve will also be flat. Be sure to draw it below the maximum value of the AP curve.
41. Why is maximizing AP not normally an economical goal?
42. Why is maximizing TP not normally an economical goal?
43. Give some real examples of factor inputs carried into Stage III. Why is this called a "tragedy of the commons"? Why does it happen? What can be done about it?

Henry George

1. Henry George carried Adam Smith, Ricardo, and J.S. Mill to what seems to be their logical conclusion. These Classical Political Economists had decried the evils of "land monopoly" (concentrated ownership of land), and lax use of good land, but had not said what to do about it. George would remedy both problems at one stroke, by taxing the land.

George was radical, in this respect, but differed from Marx in important ways. George favored working through the ballot box and democratic "friendly persuasion." He was intensely democratic, favoring direct democracy, even moreso than Mill, who favored representative government. Marx, we have seen, favored violent revolution led by a highly organized elite. George and his followers led in the adoption of the most important democratic reforms of the Progressive Era. These were:

- a, The initiative, referendum and recall system (aka The Oregon System);
- b, the secret ballot (aka The Australian Ballot);
- c, direct election of U.S. Senators;
- d, votes for women;
- e, encouragement of third parties;
- f, votes for "freedmen" (former slaves);
- g, selection of Presidential candidates through open primaries.

It was because of those reforms that Woodrow Wilson won the Governorship of New Jersey, the 1912 Democratic nomination, and then the U.S. Presidency. To show his gratitude he appointed four Georgists to his cabinet, and at least two more, Tumulty and House, to his "kitchen cabinet."

h) Where Marx organized his followers to overthrow government by force, George organized a third part and ran for public office. He came within a whisker of being elected Mayor of New York City in 1886. This office then, even more than now, was a stepping stone to higher office.

George, unlike Marx, clearly distinguished land from capital. He regarded land income as unearned, but he did not lump capital income with land rent as "surplus value," as Marx did.

George, unlike Marx, was religious, overtly and seriously so. He converted many clerics to his cause, and even tried to convert the Pope, Leo XIII. Curiously, though, the Pope treated George the same as Marx, as though George were anti-clerical and atheistic. He put George's works on The Index of forbidden books, and had his hierarchy in New York preach against voting for George, calling it a sin.

George, unlike Marx, favored retaining and strengthening most elements of the free market, laissez faire system. His radicalism consisted in proposing to

socialize the rental value and the speculative value of land, by focusing taxes on them.

✓ George's proposal is non-catastrophic in application, requiring simply a change in the existing system of taxation, whose institutional structure is already in place. Unlike Marx, he had a specific blueprint, and a short path to reach it.

George favored laissez faire, like Adam Smith - only moreso. He would have no taxes at all on production, exchange, income, sales, payrolls, business, or capital. In this regard he is more like Smith's mentors, the Physiocrats (François Quesnay, A.R. Jacques Turgot, et al.).

George, like Malthus, stressed that land is limited, but with an affirmative, optimistic spin all at odds with Malthus. To George, the means to general prosperity is to put the good land to full use, thus raising the "margin of cultivation." Malthus' dearth of land was, to George, an artificial scarcity brought on by failure of the land market to allocate land to its best use. George would remedy that failure by removing those kinds of taxes that penalize and inhibit using land fully, and instead tax the capacity of land to yield a net product, thus taxing land into full use. He foresaw limitless potential to substitute labor and capital for land, once that reform is in place, and cooperation-through-free-markets is freed from taxation.

George, like Ricardo and Mill, believed that land rent is unearned. So let's tax it away, concluded George, so we may untax productive effort and exchange. Mill had had similar thoughts, and built much of the stage on which George performed. Mill, however, hesitated before the radicalism of it, and proposed taxing just future increments of rent. George would take it all.

✓ 2. George was both a reformer, and a reconciler. A reconciliation, synthesis, or composition is much better than a mere "trade-off," where you give up some of B to get more of A. To reconcile is to get more of both A and B, by synthesizing them cleverly. Below are 14 harsh "trade-offs" and deadening dilemmas posed by austere or "dismal" economics that George's proposal purports to resolve. (See G&H, pp. 40-44.)

- a. Makes private land tenure and free markets coexist with common rights to land.
- b. Lowers taxes on labor without raising taxes on capital and without cutting public services.
- c. Enhances equity (justice) while raising efficiency of the marketplace. (It enhances equity because 1) Land rents are unearned, and 2) A few people own most of the land, and withhold it from the majority.)
- d. Finances local public services without driving away business or population.
- e. Contains urban sprawl and enhances urban synergy, without curbing free consumer choices of where to locate homes and businesses.
- f. Creates jobs without inflation, and without running Federal deficits, and without wasting labor.

- g. Attracts population without diluting the resource base (the magic here is, making the population more productive).
 - h. Makes jobs, while preserving the environment (this follows from containing urban sprawl).
 - i. Cuts waste in government in the very process of raising public revenues.
 - j. Effects a radical reform in a non-catastrophic way, using existing institutions. Thus, while Marx could mainly conspire with revolutionaries, George ran for Mayor of New York City, and in 1886 was nearly elected, creating a shock wave in American politics.
 - k. Raises revenue without impairing or distorting incentives to produce, to save, or to allocate resources to the best use. Actually improves resource allocation through the "income effects" and "wealth effects" of taxing land values. This is what is meant by "taxing land into full use." Think of the choice between growing tomatoes and barley, an example explained by chalk-talk in class.
 - l. Lets tax rates be raised without impairing the tax base (no "Laffer-Curve Effect").
 - m. Reconciles the conflict of "demand-side" vs. "supply-side" economics by raising both of them together, or "levelling upwards."
 - n. Lets market forces give free reign to large-scale production and economies of scale, without fear of domination by huge corporations, because large scale requires large holdings of land, which would be heavily taxed.
3. History suggests that voters react better to reconcilers than to candidates who offer dismal trade-offs - hence George's great popularity, and threat to the established order. Examples of Keynes and Reagan:
- a. Keynes purported to reconcile consumption and capital formation. His ideas were popular for 40 years, 1940-80.
 - b. Reagan and Laffer (1980) purported to reconcile lower tax rates with higher public revenues.

We do not try to settle whether they succeeded. The point here is that they made the claims, and achieved popularity and political power thereby. Voters react poorly to dismal economics and bitter trade-offs, like those offered in recent years by losing Presidential candidates Carter, Mondale, Dukakis, Bush (sr.), and Dole (plus many other high-spending hopefuls like Forbes, Lugar, Buchanan, Gramm, Pete Wilson, McCain, et al.)

4. George and monopoly.

George opposed monopoly profits, like most economists, and favored the competitive system. Most economists stop there, and claim that free markets make economic life fair, by competing away monopoly rents. Ricardo, Mill, and George also favored free markets, but did not agree they compete away rents, because land rents remain, regardless of competition - "they aren't making any more of it."

5. George as a political threat.

- a. Unlike many other Worldly Philosophers, George ran for public office and had a constituency, especially among Irish-Americans, and the labor movement. These held the balance of power in New York, which held the balance of power in national elections (this was 1886-97, when George was politically active). Thus, George was a clear and present danger to the establishment during the formative period of Neo-Classical Economics (NCE) when the other big threat, Marx, was being ignored (Heilbroner, p. 173). This explains a lot about how NCS was bent.
- b. The Irish connection plunged George into international politics and Vatican politics, adding to the political threat.
- c. Defenders of the status quo modified economic theory with a view to refuting George, whose analysis was based in part on Mill's synthesis of classical theory, using classical terms and concepts. This helps explain how "Neo-Classical Economics" (NCE) was developed in the particular forms it took (see J.B. Clark, below), and why Mill was gradually undermined and belittled.

6. Heilbroner's criticisms of George.

- a. George was passionate, emotional, naive, superficial, faulty, religious, etc.: lots of denigrating adjectives used, but with no support given.
- b. George attributed boom/bust cycles mainly to "land speculation" (which neither George nor Heilbroner defines). Land speculation is too small a cause to produce such large effects, says Heilbroner - again, with no support or analysis.
- c. All incomes, not just land income, are unearned "rents." Heilbroner here takes the Marxist position. Ironically, this is also standard among conservative anti-Georgists.
- d. Land rent is small, does not amount to much. This is a standard allegation of establishment economists today, but again, without support.

Heilbroner seems to be blowing George off with rather flip and superficial comments.

7. Georgist laws of motion.

- a. Cyclical. George advanced a cycle theory in which prosperity leads to overpricing land, which in turn blocks off production and triggers a downturn. Like Marx, he never worked out the details well - a task remaining for their successors.
- b. Secular. George had a cyclical theory of past history, which he saw as the Rise and Fall of Civilizations. Success and prosperity led to class division, conflict, decline and fall. He contrasted this with ideas of steady upward progress, as in Adam Smith; or a benign "steady state," as in Mill. Historians Spengler and Toynbee later elaborated the cyclical idea, which is now commonplace, but originated with George.

Optimist that he was, George saw a possible end to Decline and Fall. The "Law of Progress," he wrote, is "Association in Equality." (By "equality," he meant equality of opportunity. Like Jefferson, he believed that equalizing opportunities would result in much more equal results, as well.) His reform package was designed to enhance and perpetuate "Association in Equality."

8. Impact of George.

✓ As a practical matter, Georgism means making heavier use of the property tax to finance public services, and modifying the tax base to exempt buildings. To a surprising degree, this occurred during 30 years after his death, say from 1897-1930 in the U.S.A. By 1920, 90% of local revenues came from the property tax, and even 50% of state-level revenues.

As to income taxes, George opposed them, but considered them less bad than the excise taxes that financed the Federal Government when he wrote. When income taxation did come, Georgist influence helped focus it on property income. Georgists in Congress (allied with Populists) kept the 1894 personal income tax from exempting property income, as it otherwise would have done. The U.S. Supreme Court then declared it unconstitutional to include property, but we were spared from what would have been simply a payroll tax. This necessitated the 16th Amendment, but by the time of its first use in 1916, Georgist Congressmen (notably, Warren Worth Bailey) framed the legislation so as to exempt most wage income. Meantime Congress had also passed a corporate income tax (1909), falling 100% on property income.

In 1920 New York City, George's old stamping ground, exempted new dwelling units from the property tax from time of completion to 1932. The strongest political force behind this was Governor Al Smith, who became the Democratic candidate for U.S. President in 1928. Under this stimulus, New York City grew faster than it ever did before or after, while other older American cities were growing slower.

Georgist influence was present in the Conservation Movement, which created the National Park System, and city parks throughout the country. Urban mass transit systems with low fares were a popular Georgist cause. Urbanization called for heavy city spending on public health and safety, financed from property taxes. Public utilities and rails were subjected to the common carrier principle, outlawing discrimination against small users. Restriction of monopoly, more democratic political machinery, universal public education, utility rate regulation, and improvement of labor laws were all accelerated by Georgist influence.

Georgist influence lay behind the movement for Irrigation Districts in California, beginning with the Wright Act of 1887. These Districts took the lead in making California the leading farm state.

H. GEORGE - Questions

1. H. George's policy proposals purport to reconcile many harsh trade-offs or paralyzing gridlocks posed by "austere" economists. Itemize and explain at least four of these "TANSTAAFL Traps," and how George's policies would resolve them benignly. Optional: Continue with as many more as interest you.
2. Growth of commerce, and privatization of land, broke down the older classes of guild craftsmen (masters, journeymen, apprentices, etc.). However, Malthus and Ricardo showed how society was being divided into new classes of haves and havenots. Mill, Marx and George saw ways of overcoming this new

class structure.

- a. What was the new class structure?
 - b. What were their respective proposals?
3. Itemize some similarities and differences of Henry George and the following predecessors:
- Adam Smith
 - David Ricardo
 - J.S. Mill
 - Karl Marx
4. Explain how Keynes and Reagan-Laffer succeeded politically by seeming to reconcile frustrating dilemmas or harsh trade-offs.
5. a. What secular "Laws of Motion" did George see in history? b. What did he propose doing about it?
6. What was George's impact on public policy?
7. Optional: you may need help from the Instructor.

Henry George said that a tax imposed on the costs of producing a good may lower the amount produced and sold, by aborting production at the margin. (The other possibilities are that it might raise the price, or be absorbed by the producers you may ignore those here.) Illustrate this point graphically, beginning with Ricardo's law of rent.

Extra hard: On the same graph, illustrate the two other possibilities.

8. Many ordinary economists say free markets make economic life fair, by competing away monopoly rents. Ricardo, Mill, and George also favored free markets, but did not agree they are enough to compete away rents. What other source of unearned income did they identify? What would they do about it?

H. GEORGE - Answers

1. See Henry George, #2.
2.
 - a. The new class structure featured a proletariat, lacking both land and special skills, with nothing to offer but its labor for sale to landlords, who offered few jobs, and a growing class of industrial employers.
 - b. Mill proposed taxing inheritances, high incomes, and future increments to land rents. Marx proposed socializing all "means of production," fusing land and capital. George proposed taxing mainly the rental capacity of land, while UNtaxing most productive human effort. George regarded saving and investing as part of "human effort," and so would UNtax capital, the product of saving and investing. To understand George you have to grasp this distinction he drew so sharply between producers and leeches.
3. Henry George resembled Adam Smith by favoring laissez faire and opposing private monopolies. George differed in favoring a more drastic attack on land monopoly (through taxation). Smith saw capital formation as a panacea, beneficent to labor, and the whole nation; George stressed labor's need for better access to land, in the absence of which capital controlled by landowners might simply displace labor.

Henry George resembled David Ricardo in seeing society divided by a wedge driven between landowners and workers: a class structure. Henry George adopted and made much of Ricardo's Law of Rent, and applied it to urban land and all resources as well as farmland. Ricardo saw growing population raising rents mainly by pushing on the means of subsistence. George stressed the rising productivity of population in cities, so long as they lived in "association with equality." George ascribed urban rents less to population pressure, and more to the superior productivity resulting from synergy made possible through market relations, in well-ordered cities free of taxes on exchange.

Henry George resembled J.S. Mill in distinguishing land from capital, and favoring land reform and more equal distribution, effected through taxation. George learned much of his basic economics by reading Mill. George thought Mill overlooked the incentive-damage from progressive income taxes, and was too timid about raising land taxes, which serve to equalize wealth and simultaneously improve incentives, and free up production and exchange from taxation.

Mill was devoted to small enterprises, especially in farming, while George accepted the inevitability of large-scale production, and sought to achieve social equity by taxing the vast and valuable lands that large-scale producers require. On this matter, George underestimated the power of his own reform. Experience with it has shown that it has, where applied, generally forced subdivision, and exposed "economies of scale" to be in some large part simply a myth circulated by and for *latifundistos*. An example of this nearby us is the contrast between the two San Joaquin Valleys: the east side, characterized by heavy use of land taxation and small family farms, vs. the west side, with little land taxation and gigantic farm units. To observe this, simply drive north along I-99 (the east side), and return on I-5 (the west side).

Henry George resembled Karl Marx in seeing a need for radical social reform, including making land common property. George shared Marx's belief in economies of scale, and the need to come to terms with it by new legislation. George shared Marx's concept that

capital is stored-up labor, although they took that common concept in different directions. Both men began from acute awareness of how the Enclosure Movement had changed modern society by divorcing labor from its traditional lands, and creating a landless proletariat and a class society; both men sought modern means to restore the relative bargaining power of labor. Both men had been journalists, observers trained to insist on evidence.

Henry George differed from Marx in favoring laissez faire, private ownership of capital, and personal freedom. George retained the Classics' distinction of land from capital, while Marx generally ignored it. Henry George was religious, although unchurched and ecumenical, with a teleological streak; Marx was a militant atheist whose streak was more Darwinian. Henry George was an indigenous product and part of his society and culture, while Marx was a transplant, a recluse and revolutionary. George's tools were the lecture, persuasion, and the ballot; Marx's were conspiracy, a leadership elite, and the gun.

4. Keynes taught that capital formation depends on investing; that the urge to save is too strong anyway, and needs no reward. By consuming more, he wrote, we encourage more investing, thus creating capital as a by-product of consuming. This viewpoint won many elections, 1936-80.

Laffer taught that lower tax rates result in higher tax revenues, by releasing the latent work-effort now suppressed by high taxes. This belief elected Ronald Reagan, 1980, and then George Bush, 1988.

5. See Henry George, #7.

6. See Henry George, #8.

7. See your Instructor and/or his lecture notes.

8. Ricardo, Mill and George saw that free competition in open markets will compete away monopoly rents, but not land rents, the main source of unearned incomes.

Ricardo would avoid public policies like the English Corn Laws that add to land rents. Mill agreed, but would also tax away future increments to rents. George agreed, but would also tax away past increments to rents.

Karl Marx

1. Marx was bred in the spirit of the uprisings of 1848 in Europe. This was the age of Les Mis. Marx found refuge in England.
2. He was an angry, authoritarian personality – not someone you would want to live with.
3. He made much of “Dialectical Materialism,” a philosophy of historical evolution. The idea that there are “Laws of Motion” in a system proved very popular, and helps account for the persistence of Marxist studies in a culture (ours) that is basically hostile to Marx. Heilbroner imputes limited laws of motion to prior worldly philosophers, but relative to Marx they were quite static, while later “Neo-classical Economics,” as developed by Alfred Marshall and J.B. Clark, became totally, ridiculously static and “ahistorical,” relying mainly on a priori reasoning, leaving a wide-open field for Marxist economic historians. Since those who write history control the future, that was a major blunder by neo-classical economists.

a. “Dialectical” means evolving through constant struggle and clash of opposites, followed by their synthesis into a new social form, followed by a new struggle with a new opposite.

The idea of evolution through struggle has a lot in common with Darwin’s natural selection, and the two ideas grew about the same time. Darwin, however, led to genetic elitism, where Marx led toward the determinism of external circumstances.

b. “Materialism” means that the social forms that struggle are informed by ideas that spring from current modes of production and exchange. They are not just abstract ideas, they have a technological basis. More than that, though, they have an “institutional” basis, e.g. who owns what? “Social forms” sounds abstract, but it means entitlements to property: their historical origins, and the laws and courts and police and armies that support them. Marxists dramatize this by referring to capital as a “relation,” meaning it gives the owner a commanding relationship over those whom he hires. Social relations are mainly a class struggle between two sharply defined classes, the bourgeoisie (owners and employers) and the proletariat (hired workers). Marx oversimplified, of course, and people have resisted being sorted into just two classes, and yet the concept of class struggle is a useful concept to explain politics in all ages and climes. It’s the “haves” vs. the “have-nots.”

Institutions

Marx fails to distinguish between the haves who own land, and others who have capital. Occasionally he does, but generally he assumes they go into league with each other, and team up to exploit the proles. It’s an interesting point, to which we shall return. In the early history of capitalism in France, the followers of Calvin, called Huguenots, were small capitalists who allied with the proles to combat the dominant landowning class. Later, after winning some security, the small capitalists joined the landowners to suppress the proles. Some

modern economists have equated capital with labor on the grounds that capital is a labor-product.

c. In simpler terms, Marx was saying that the industrial revolution called for a new set of laws, especially laws about property rights and contracts. Laws? Marx saw them as tools of the capitalists, along with their lawyers and courts. He wanted a dictatorship (supposedly of the proletariat) to supersede laws, and serve the proles.

Marx's dialectic is nearly deterministic, but not quite. He calls on his followers to get on the bandwagon of history, but also to give it a little push, to "hurry history along." Logically that does not quite add up, but psychologically it is effective, and psychology is what moves people to act. Calvin (founder of Presbyterianism) used it before Marx, and Mohammed used it before Calvin. Today, modern theocratic evangelistic Presbyterians (a minority of Presbyterians) are using it again. Gary North, a combination economist, evangelist, and politician, writes that "Power flows from faith in the inevitability of a cause" – his cause, of course, which is an amalgam of Calvinist theocracy and Tory economics. We call it "bandwagon" psychology, seen in modern elections, team cheering sections, and mass meetings of all kinds. These can be frighteningly authoritarian; Hitler, of course, was a master at manipulating and stampeding people this way.

e.g. Momentum of King

Critics accuse Marx of determinism, but that is too easy. Any explanation of cause and effect is partly "deterministic," so this is not peculiarly Marxian.

4. The major materialistic change needing a new social form was the eviction of peasants from their former lands, creating a proletariat. The factory system and industrial revolution did not create the landless proletariat: the enclosures came first, beginning with Henry VIII in the 16th Century. Before the factory system there was "cottage industry," a system where entrepreneurs "put out" raw materials to cottagers who worked them up at home, e.g. by spinning and weaving. The landless proletariat alone did not create the industrial revolution: Rome had a similar enclosure movement and a landless proletariat, from the 2nd Century B.C. (Punic Wars), but no industrial revolution. Many 3rd World Countries today have latifundios and proletarians, but little industry. It was a combination of landlessness with the growth of science, rationalism, freedom of exchange, and relatively good government (i.e. better than Rome) that produced the industrial revolution. England, compared with old Rome, had a thriving commerce, more political and personal freedom, more social mobility, and the stimulus of competition from other nations and little city-states: England learned a lot from northern Italy, Germany, Flanders, and Holland.

5. "Contradictions of capitalism" seen by Marx.

(a.)

Production has become interdependent and/or regimented, while property remains individualistic.

(b) Bourgeoisie produces its own grave diggers by organizing the proletariat in factories.

(c) a. Capitalism produces an abundance of goods, but pays workers too little to buy them. (This idea keeps cropping up, and not just from Marxists. Its generic name is "underconsumptionism.")

6. Labor theory of value. Labor produces all value. Incomes skimmed off by non-labor are called "surplus value."

Ricardo had earlier advanced a value theory (an explanation of why goods have value) in which labor, capital, and land, all three, jointly added value to goods. Ricardo saw capital as a productive agent that adds value, and thus justifies its returns (he wasn't so sure about land). Modern economics derives more from Ricardo than Marx, but Marx has had heavy influence, too. (Ironically, and confusingly, many people do not read carefully, and parrot errors they pick up from "authorities," and the false rumor has gotten around that Ricardo himself advanced the labor theory of value. This is wrong, wrong, wrong – which is why it pays to read the originals to check up on the commentators.)

*Modern Ecs.
evolved to
refute Marx
& George.*

In Marx's version, capital is not productive in itself, it is all stored-up labor, which is used by capitalists to extort "surplus value" from the labor that produced it. To Marx, capital is not a thing, or a group of things, but a "relation," a means by which one class exploits another. That is a strangely abstract way of putting what could be a simple idea, but it has staying power among Marxists, and remains an integral part of their private language. The implication is that capital is not productive, but only a means by which its owners exploit workers. This idea, if stated plainly, would be hard to sell, which may account for the abstract language.

✓ In Ricardo, land rent is unearned income, but Marginal Rates of Return (MRORs, as defined earlier) reward savers for the self-restraint required to provide and preserve capital. Marxists fiercely ridicule any idea that rich people exhibit self-restraint or "abstinence" when they preserve their capital, but, the rich are subject to temptations and wild dissipations we can hardly imagine. For them, "abstinence" from consumption carries a totally different meaning than for you or me. The proclivity of some of the very rich to dissipate their fortunes in wild extravagances is an historical fact of wide notoriety – witness the recent loss of \$30 billions or so by the prodigal Prince of Brunei, who yachted from casino to casino with an entourage of four wives, dozens of concubines, servants, fast cars, gold-plated plumbing, and whatever other toys he might fancy.

✓ Marx widens the idea of unearned income to include all returns to capital, which he fuses with land in the term, "means of production." No return is justified or needed to encourage saving and investing: i.e., capital is just like land, to Marx and Marxians. Capital is inherently exploitive, and not productive.

We will see that the later reformer, Henry George, revived Ricardo's distinction of land and capital; and that the American "Neo-classical" economists, following J.B. Clark, revived Marx's fusion or melding of land and capital.

7. Cyclical theory: declining "rate of profit" towards end of boom leads to a crash. How?

a. Under-consumption.

b. Rising wage rates lead to rise of labor-saving capital. (This much is good economics.)

c. This forces wage rates back down. However, this does not help employers make profits, because employer now hires less living labor, and surplus value comes only from living labor. (This part is nonsense.)

8. Mill's redistributive ideas are politically impossible, by Marx: ruling class will not tolerate it. (Mill was right, for a century; Marx may be getting validated today.)

9. Marx's forecasts.

a. Falling rate of profit? Probably wrong, but he did not define "profit," so who knows?

b. Technological advance. Duh - of course, who doesn't forecast that? But the key question is the one Mill raised: will it benefit workers or landowners?

c. Series of crises. Yes, but: did Marx forecast this, or did later Marxists read it into his obscure prose? I haven't found it in his major work, *Capital*. Doubtful if wage rates peak before crashes. Rather, there is a spike in interest rates.

d. Growing concentration of wealth and industrial power.

Yes, although this is cyclical.

e. Capitalism will break down. Marx does not define "Capitalism" clearly, so who knows? The breakdown of governance that did occur was in Russia, 1917, where Marx least expected it. Now, of course, First World nations show little signs of "breaking down," although they came close in the 1930s.

K. MARX - Questions

1. Marx identified a recent historical change that called for a new social order. What was it?
2. Marx popularized a new Law of Motion in history, that he named "Dialectical Materialism" (D.M.).
 - a. What does he mean by "Dialectical"?
 - b. What does he mean by "Materialism"?
3. Is D.M. "deterministic" (Destiny is predetermined)?
4. Is D.M. "teleological" (Nature is shaped by a Purpose, some grand eternal plan)?
5. What are Marx's "Contradictions of Capitalism"?
6. What is Marx's "Labor Theory of Value," and how did it compare with that of Ricardo and other classical political economists?
7. Marx based much of his economic analysis on the "Classical Political Economists" (Quesnay, Smith, Malthus, Ricardo and Mill), but what became of land rent, which these "Classicals" had given such a central role?
8. Was Marx authoritarian?
9. What did Marx forecast?
10. What was Marx's blueprint for the new social order?

K. MARX - Answers

1. The enclosure movements, by which labor was evicted from and divorced from the land, turning it into a landless proletariat, a mere commodity in the market lacking basic rights of humanity. The landless "prole" has no right to be here, except by coming to terms with landowners.

The industrial revolution did not create the landless proletariat: the enclosures came first, beginning with Henry VIII in the 16th Century. The landless proletariat alone did not create the industrial revolution: Rome had a similar enclosure movement and a landless proletariat, from the 2nd Century B.C. (Punic Wars), but no industrial revolution. Many 3rd World Countries today have latifundios and proletarians, but little industry.

2. a. "Dialectical" means evolving through constant struggle, and through the clash of opposite or competing social forms, followed by their synthesis into a new social form.

The idea of evolution through struggle has a lot in common with Darwin's natural selection, and the two ideas grew about the same time. Darwin, however, led to genetic elitism, where Marx led toward the determinism of circumstances.

b. "Materialism" means that the social forms that struggle with each other spring from modes of production and exchange i.e., they are not just abstract ideas, they have a technological basis.

Social forms also have a social basis or "structure," meaning entitlements to property: their historical origins, and the laws that support them. Marxists dramatize this by referring to capital as a "relation," meaning it gives the owner a commanding relationship over those whom he hires. Social relations are mainly a class struggle between two sharply defined classes, the bourgeoisie (owners and employers) and the proletariat (hired workers).

c. In simpler terms, Marx was saying that the industrial revolution called for a new set of laws, especially laws about property rights and contracts.

3. Not quite, although it comes close. However, any explanation of cause and effect is partly "deterministic," so this is not peculiarly Marxian.

Adam Smith, Thomas Malthus, and John Stuart Mill were each deterministic in the sense that they made long-run forecasts based on their understanding of cause and effect. So did Marx, but Marxists call them "Laws of Motion," suggesting they are inevitable, and not just one person's subjective forecast.

Ideas may help change the social structure, but they spring from it, which limits the role of "free will" in affecting historical change. (If there are "Laws of Motion," there cannot be too much "free will.")

Ricardo and Mill saw mankind hemmed in by natural laws like diminishing returns, but within those natural constraints they saw man as free to choose, both individually and collectively. Marx downplayed Nature as a constraint, and substituted social structure as the main constraint.

4. Marx rejected any religious concept of a Divine Purpose. However, he replaced it with an ideology so powerful that, to some observers, Marxism seems to be a kind of religion itself - a secular religion. Like Calvinism, it sees society swept along on an irresistible current of evolution, led by a small elite whose task is to "hurry history along." Thus, without being overtly teleological, Marx substituted a secular concept of inevitability that filled the same philosophical or emotional need.

5. Contradiction #1. Modern industry makes production and exchange highly social and interdependent, while property remains individualized. This creates a tension that will be resolved ultimately by socializing property.

Contradiction #2. The bourgeoisie produces its own gravediggers, the landless proles. Marx thought they would unionize, because assembled in factories; and unions would create socialism.

6. Marx said the value of something is the amount of labor it embodies. Ricardo had written something similar, but Ricardo had also allowed for the input of time, and the contribution of land. Marx regressed from Ricardo's explanation of the sources of value. Marx's explanation is not "simple," for he tortured it to meet objections; but it is, at root, too "simplistic."

Both Ricardo and Marx saw value from the cost or supply side, as we say today. Later economists gave more emphasis to demand's effect on value.

Marx described capital as stored-up labor, or "dead labor." That's all capital is - he belittles saving as a source of capital. Dead labor combines with living labor to produce wealth, in Marx's view, so labor produces all value. The incomes of both landowners and capital-owners are "surplus value" extracted from workers, who produce all value.

7. In his treatment of land rent, Marx did not follow his classical preceptors, but either ignored land, or fused it with capital. In this respect, Marx is more of a "neo-classical" economist. Classical Political Economy was "3-factor economics." Marx converted it into "2-factor economics," and thus lost much

of its analytical power.

In Book III of *Das Kapital*, published posthumously and edited by Engels, Marx reconsiders, but this has had little or no effect on Marxists.

8. Marx had an authoritarian personality, which tended to attract followers who tolerated or preferred authoritarianism. This helps account for the adoption of Marxism in Russia, the most authoritarian state in Europe (although other factors were involved).

9. Marx's main forecasts.

a. The rate of profit will fall. This is a secular (longterm) trend, but also occurs cyclically, at the end of each boom in the boom/bust cycle. The secular forecast is often identified with Marx today, but is also found in Smith, Ricardo and Mill. However, Marx ascribed it to different causes.

What makes this rate fall, by Marx?

(1), Inadequate consumer demand.

(2), Substitution of capital for labor. Marx's terminology here is peculiar to Marxists: he calls this the rising "organic composition of capital." It forces wages down. (Note how Marx takes the Luddite view here, in contrast with Adam Smith, who had capital formation pull wages up).

You would think this added demand for capital would raise the demand for capital, and raise the marginal rate of return (MROR). However, Marx has it work the other way. His reasoning here is tortured and unconvincing, and flawed by his failure to define "profit," or to understand the difference of MROR from AVERAGE rate of return (explained earlier). He says the employer now is using more dead labor and less living labor, and profits come only from exploiting the living labor, so they fall. Thus, everyone is worse off (Marx, like Malthus, was a complete pessimist, who would not be comforted).

He would have done better to remember what J.S. Mill had written. Capital that substitutes for labor, raises the demand for land, which helps explain a squeeze on both wages and capital-returns. It remained for Henry George to point that out.

b. Capitalism will lead to a series of crises. The market mechanism is not self-correcting; the system will collapse.

c. Ownership and control of industry will grow more and more concentrated.

d. Capitalism will break down, at which time the revolutionaries will strike, and inaugurate a new order, the dictatorship of the proletariat.

10. Marx produced no blueprint for the Marxist society. He mainly criticized capitalism, and forecast its evolution and collapse, followed by the dictatorship of the proletariat. What the world knows as Marxism was forged in Russia, and turned out to be the dictatorship of Lenin and Stalin, who used Marx's name, but applied ideas of their own.

Mon. Nov. 25

- I. Laws of Motion (forecasts) Good framework for gas
- Mass
- Physics
- Smith
- Malthus
- Ricardo
- Mill (if unknown makes progress)
- Wallace
- Utopians?
- George
- Mure

II.

Marx

- A. Historian & forecaster: Laws of Motion
1. Dialectical. Evolution thru struggle.
 - Conflict ff. by merging. (David Harman)
 2. Materialism

The mkt. is mightier than the pen.

People organize around bread & butter issues. (He cd. not imagine a modern election where people raise catch politics to a major line of cleavage. Religious strife he wd. give a class struggle interp.)

3. Religion - opiate of the masses.

4. Law - tool of the rich. Replace w. dictator.

5. Class struggle - rich & poor. No divide the rich into land & K

6. a) K is a "relation" used to exploit labor
L and K all same. Neither is productive - only labor is.

b) Labor produces all value. What we call K is "frozen labor."

~~7~~ Contradictions of K-m

c) K needs no incentive. Same as rent: unearned inc.

a. Prodn is indep., but ownership is by individuals.

b. Bourgeoisie org. proles in factories, where they minimize

c. Unconscious.

8. Periodic crashes.

9. Police reform a la Mill is impossible.
Org. to rebel.

10. K-m will break down. Then, seize control
Almost happened, 1929-33 — but fascists seized control.

11. Comm. victory is inevitable.
Like Islam, Calvin. Predetermination.

Alfred Marshall, The Great Compromiser

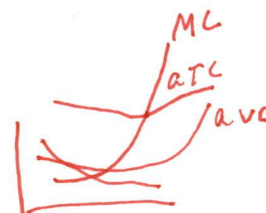
1. Marshall was a Centrist in several ways. In policy he was conservative but compassionate (noblesse oblige), bending and understanding. He reflected the temper of "Edwardian"² England, when old-guarders were conducting a long strategic retreat in the face of aggressive radical offensives. (*George, Marx, Wallace, Fabians*)

In methodology, he reconciled cost-side value theory with demand-side value theory (#4, below). He straddled the fence between classical political economy, and neo-classical economics, smoothing the transition.

His "compassion" went farther than what we call "liberal Republicanism" today (what's left of it). He saw eliminating poverty as a major goal of economic policy (LBJ's "War on Poverty" was not a brand-new thought in 1965). Marshall's conservatism was in not wanting to disturb existing institutions much. One might call this "passive conservatism," as distinct from aggressive or predatory conservatism (e.g., of those who want to seize public lands for private profit).

2. Marshall kept the classical trinity of factors of production: land, labor, capital. In this he differed from more militant and overt neo-classicists like the Americans Alvin Johnson and Frank Fetter and Frank Knight, who conformed to J.B. Clark.

However, Marshall changed the basic unit of analysis in economics from the parcel of land, with diminishing returns to labor and capital, to an abstraction he called "the firm." This corresponds, in blackboard graphical analysis, to the switch from "productivity" curves to "unit cost" curves. In the productivity analysis, land may be held fixed, while labor and capital vary. In the unit cost analysis, "fixed cost" may include anything, and variable cost may include anything, thus blurring the distinction among factors of production. Adding to the blur, "the firm" may add indefinite quantities of "fixed" factors of production in a period of time that Marshall christened "the long run." Thus, changes in factor proportions are blurred together with changes in scale of "the firm," and the fixity of land to a city or nation is easily overlooked. Whereas "firms" may add land, the same as they add labor or capital, and whereas economies are just collections of firms, ergo (by strong implication) economies, nations, and the whole world may add land at will.



3. Marshall's analysis is mainly static, like J. B. Clark's, and in this sense, "neo-classical."

a. He says little about boom and bust, although he lived

² King Edward VII, 1901-10. "Edwardian" generally includes the first years of his successor, George V, as well, 1910-14. The Era's marked feature was a string of three "Radical-Liberal" governments, 1905-14, corresponding in spirit with the three "Progressive" administrations in the U.S.A. (Roosevelt, Taft, Wilson). Note in passing that the first two were Republicans: "Progressivism" was bipartisan. Leftwing Progressives Hiram Johnson and Robert La Follette were both Republicans. There was a strong echo of Republican progressivism in Earl Warren, longtime Governor of California, vice-Presidential candidate under Thomas E. Dewey, 1948, and Chief Justice of the U.S. Supreme Court.

through the crash of 1893. He and Clark left the profession unprepared for the Crash of 1929.

b) He is silent on secular "Laws of Motion." He lived in exciting, dynamic times, but viewed them in tranquility, with equanimity. England underwent a political revolution, as labor got the vote and learned to use it. Germany challenged England's navy, leading to a costly world naval race. Ireland was constantly boiling over, and achieved Home Rule under Michael Collins. World War I occurred, then the Russian Revolution.

c) In the midst of this turmoil Marshall, unperturbed, retained and elaborated ideas of benign equilibrium and incremental adjustment, with no quantum leaps or catastrophes. In this sense, he was "cloistered," as Heilbroner writes. In Marshall, time is just "abstract time" (see §6), not historical time. All changes are glitchless, and reversible.

4) He perfected a new value theory, showing how supply and demand work together to determine equilibrium price and quantity in each market. This composed classical economics, where cost determined value, with neo-classical claims that demand alone determined value.

5) Supply and demand.

a) Review Ricardo's law of rent. The price (of a commodity produced from land, e.g. corn) is given (graphically, a flat curve); cost of production at the margin comes to equal price, as the margin moves onto worse land. Graphically, this is shown as a supply curve (cost per unit) that slopes positively, rising to cut the flat price curve at the margin.

b) Marshall changed the price line from flat, to negatively sloped.

c) Value of a commodity (e.g., corn) is determined where the curves intersect. This also determines quantity produced and purchased.

d) A new source of rent is now seen: "consumer surplus." It is the area between the price, and the demand curve. The instructor should show this graphically.

C.S. may "lodge" in land.

6) Treatment of time.

Marshall divides the future into "short run" and "long run." The "long run" is a period long enough for a "firm" to change its "fixed" capital. This is a compromise between ignoring time, as Clark did, or treating it more fully, as Ricardo (nearly) had (and Wicksell did). (We did not study this part of Ricardo's work.) The allure of Marshall's compromise is its simplicity, not its adequacy.

a. In the short run, supply is fixed (vertical supply curve). This turns all incomes into rents. Marshall said "quasi-rents" for things like buildings that are fixed in the "short run."

b. In the long run, supply is highly responsive to higher price (horizontal supply curve). This eliminates producer rents, but leaves consumer rents.

This involves the fallacy of having all firms produce at same cost. Marshall invented idea of "the representative firm," intimating that all firms are pretty much the same. This can be used to eliminate the idea of Ricardian rent, as J.B. Clark wanted to do, but by a different route than Clark took.

c. In addition all changes are reversible, to Marshall. There is no real historical time, just abstract, conceptual time.

7 Marshall and rent.

One may, if one wants to, use Marshall either to universalize rent (short run), rendering it meaningless; or eliminate all producer rent (long run), leaving an implication that only "consumers" receive rent, justifying sales taxes. Marshall was artful at conceding something to everyone, leaving others to use his analysis any way they might want.

*Competing away
+ importing
away.*

8. Incrementalism.

In Marshall, all adjustments are small and incremental. His motto: "Nature makes no leaps." There are no discrete changes, no mutations, no quanta, no explosions, no crises, no chasms to cross nor cliffs to scale, but just fine continuous changes, as in calculus, Newtonian physics, or Darwinian evolution. Cf. §3, above. This is inconsistent with dividing all time into just two parts, short run and long run (§6). Marshall probably viewed that as a simplifying teaching device. He was handy with math, but knew better than to assume his readers were. He never got into how firms morph from short run to long, but assumed it could occur smoothly.

The result of "Nature makes no leaps" is to keep economic analysis and its conclusions safely inside the psychological "comfort zone," which attracts many people. It repels others, however, for two good reasons. One, it leaves out the drama and excitement and challenge of major crises and shocks. Two, it nurtures skepticism about the possibilities of grand reconciliations like those described earlier in Laffer, Keynes, and George.

9. Decreasing costs



Urbanizing. Trolleys. Subways

10. Hotelling's Bridge - from decreasing costs to Δ costs

Current need for demand mgmt.

A. MARSHALL - Questions

1. What "Laws of Historical Motion" did Marshall advance?
2. Was Marshall a "leveller" (like Mill), or an "elitist" (like Edgeworth, Clark, Pareto et al.)?
3. Was Marshall a gradualist?
4. How did Marshall reconcile cost-side value theory (e.g. the labor theory of value) with demand-side theory?
5.
 - a. What is "quasi-rent"?
 - b. What happens to quasi-rent "in the long run"?
6. Explain how Marshall analyzed how prices are determined: a) in general; b) in the short run; c) in the long run.
7. Marshall's model presents a concept of the "firm" as a disembodied spirit. It has been used to turn the rent of land into a cost production, even though land itself has no cost of production. Explain this point, and its policy implications.
8. Explain two meanings of "the demand rose":
 - a) with price constant;
 - b) with price variable and other things constant.
9. Did Marshall agree with Malthus and Ricardo and Mill that land scarcity could be a serious problem?
10. Did Marshall agree with Marx and Malthus and Hobson that shortness of consumer demand could be a serious problem?
11. How did Marshall explain problems like depression and unemployment?

A. MARSHALL - Answers

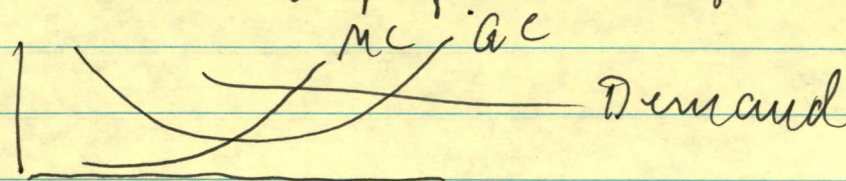
1. None: Marshall's work is "ahistorical."
2. Both: he was a compromiser and middle-of-the-roader in this, as in most matters.
3. Yes. His motto was, "Nature makes no leaps." Any reforms he proposed were to take place in small steps, phased in over long periods.
4. With the theory of supply and demand, which all economics students should master early on.
5. a. "Quasi-rent" is the return earned by an input that is fixed "in the short run," so it would be there and in use, even if it received nothing for its services.
b. In the "long run," quasi-rents disappear, because all inputs are variable to the firm. This idea can be used to allege that even land rents disappear, because land is variable to the firm. Land rents have not disappeared, however, so this idea is confusing and erroneous.
6. a. In general, Marshall has prices determined at the intersection of a supply curve, positively sloping, and a demand curve, negatively sloping. The Instructor should explain this graphically, labelling the axes carefully.
b. In Marshall's short run, supply curves are vertical, or at least steep, so variations in demand determine price.
c. In Marshall's long run, supply curves are horizontal, so cost of production determines price, and the only rents left are consumer rents (consumer surplus).
7. Marshall's "firm" is just an abstract organization that buys or rents all its inputs from others. To the firm, land is just another hired input.

The policy implication is that land is not distinctive; its income is no more unearned than that of any perspiring worker, and it should not be singled out for heavier taxation.
8. It is optional with The Instructor to explain this, with a graph.
9. No, Marshall set up a model based on "the firm," which may add land as easily as it adds labor or capital.
10. No. Marshall saw few problems.
11. He ignored them.

Wed. Marshall

1. Compromise. 2-handed ecst.
 - a. ~~Value~~ Value - cost of produce or utility?
 - changed unit to output, so cd. show price ~~not~~ changing.
 - changed fixed land to FC.
 - " name from produce & distribute. thy to price thy. (Micro covers both.)

b. New set of graphs - recipe of old

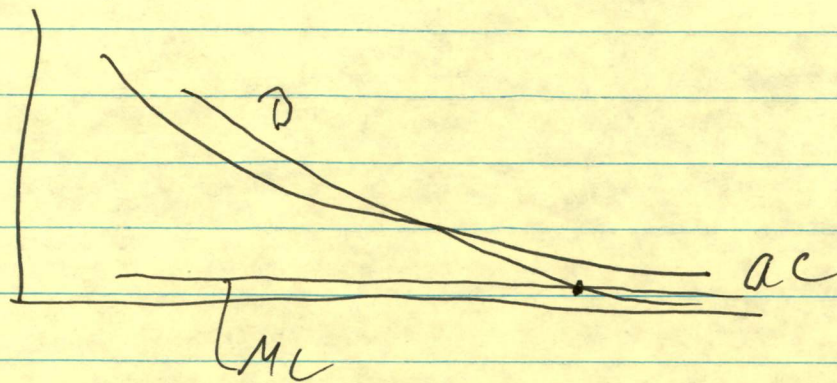


Dim. Ret. becomes Δ costs
High cost firm becomes low-cost firm

- c. Ric. went got lost.
 - High-cost firm can become low-cost by adding FC.
 - Focus on firms & commodities, not grades of land.

2. Marshall cd. shift back & forth from Ric. model
3. ~~2~~ "Add up all firms, get S curve" to core model, but lesser minds
4. Add all demands. cd. not.
5. Join, get S & D

6. The Rule: $P = MC$
 1. New kind of rent - Cons. Surplus -
 8.8. Deadw. cost



9.8. Static (#3)

John R. Hobson

1. There was an upsurge of imperialism, 1870-1914, climaxing in World War I, 1914-18. However, imperialism was not as novel as Heilbroner makes it look: it is as old as mankind, and was an integral and explicit component of Mercantilism.

2. Hobson adopted "under-consumptionism" (put the blame for poverty and depression on over-saving by the rich). This was a new way to attack the unequal distribution of wealth. Hobson was quickly cast out of English academia, or "Oxbridge." That was partly because the function of Oxbridge was to cater to the rich, but also because classical political economists Ricardo and Mill, who did not cater to the rich, had no truck with underconsumptionism, either. They taught something called "Say's Law," discussed when you get to Keynes, below. At any rate, Edgeworth led the charge against Hobson. (Later, under Keynes, underconsumptionism became respectable at Cambridge, and soon thereafter in the U.S.A. as well. Malthus and Marx also shared this worldview.)

3. Influence of Cecil Rhodes on Hobson.

a. Rhodes was an aggressive Anglo railroad and empirebuilder in S. Africa; he started the Boer War there, 1899-1902.

b. Rhodes rationalized The Empire as a safety-valve or vent for surplus English labor, like the American frontier to Horace Greeley ("Go West, young man). Hobson modified that to a vent for surplus savings, resulting in an export balance from England. He wrote Imperialism, 1902.

✓
④ Weaknesses of Hobson's thesis:

a. Europeans and their capital moved to many lands without conquest, e.g. to the new U.S.A. even after the Revolution had resulted in confiscation of Tory lands, and even after repudiation of many state debts after the crash of 1837.

b. World War I began and was centered in Europe; the colonies were incidental.

c. England ^{needed} capital at home, because at this time its industrial plant had fallen behind newer-industrialized nations, notably Germany and the U.S.A. What stifled demand for capital in England was monopoly control of its industries, not a surplus of capital per se.

5. Marxists, who needed a boost at this time, embraced Hobson. The idea helped revive Marxism. Lenin published his own version of Imperialism, adding the Marxist dogma of inevitability. Soviet paranoia, 1918-90, was based on this dogma. (Current western incursions into Russia suggest it was more than just empty dogma.)

6. Many colonies did not pay, overall, so why did nations want them?

a. They did pay off for a few people; these few manipulated and led along the many, exploiting honorable but misguided instincts of patriotism and national

defense. The instructor will give data on the profitability of ARAMCO, the Arabian-American Oil Company.

b. Cultural Imperialism also a factor. Heilbroner says it has now replaced seizure and protection of property as the force behind U.S. imperialism, but this seems to be a blind spot in Heilbroner. Today's codewords are different - democracy, free trade, liberalization, economic development, green revolution, etc. - but the main idea is to acquire, hold, or recapture private property, as in Cuba and Viet Nam, and to privatize and acquire public property as in Russia. Cultural imperialists, like missionaries of old, are handy fronts for land-grabbers.

7. Raw materials, "mercantilism," and imperialism.

a. Meaning and history of mercantilism as control and exploitation of colonies. (Acquiring gold was incidental.)

→ b. Concept of vertical integration, by firms and nations. It means you cannot rely on the free market in raw materials, so each firm and nation must have its own. Here is something that really does lead to warfare, in the most direct and obvious ways. I.e., you do not mainly send capital abroad, you mainly acquire land there.

✓ The four sources of foreign assets: 1, Capital Export; 2, Plowback of earnings; 3, Appropriation of lands; 4, Appreciation of the lands, once appropriated, or acquired cheaply.

8. Multinational corporations are now growing more powerful than many nations.

a. This has happened before: the Renaissance; the East India Company (18th Century).

b. Current shift of emphasis from raw materials to outsourcing; growing competition of third world labor with U.S. labor.

c. Heilbroner's non-forecast, p. 206: "too soon to foretell." Counterfeit wisdom.

✓ 9. Successes of indigenous economic development: Japan, Taiwan, S. Korea, Singapore, Sydney, Johannesburg. Failures of transplanted development: Manila, Latin America, Saigon.

J. R. HOBSON - Questions.

1. Marx's Laws of Motion had capitalism weaken itself until it gave way to a successor socio-economic system.

a. How did Hobson modify Marx?

b. How did neo-Marxists like Lenin modify Hobson?

c. How was Hobson influenced by Cecil Rhodes and the Boer War?

2. Smith, Malthus, Mill and Hobson all saw "Laws of Motion." These were forecasts of how the economy would evolve over time. Briefly compare Hobson's views with the forecasts of each of the other three. Note, as you go, which ones support which others, and in what specific ways? Here's an example of how to start. "Hobson, like Malthus, saw worsening conditions ahead, but for different reasons." (When you get ahead to Mill and Hobson, you needn't repeat this just say it once.)

3. What words in the Glossary help you understand Hobson?

4. Define "underconsumptionism." What new wrinkle did Hobson give it?

5. How did Hobson modify the ideas of Cecil Rhodes?

6. What form or forms does Imperialism take today?

7. What is or was "Mercantilism"?

What is "vertical integration"?

How do they relate to each other?

J. R. HOBSON - Answers

1. Hobson had capitalism save itself from a surplus of savings by investing them overseas. This led to imperialism, rivalry, and warfare - with the warfare soaking up still more savings.

Lenin soon modified Hobson by making the process inevitable and incurable, except by the conquest of capitalism by communist Russia. This of course led to a high level of mutual distrust.

Hobson took in Rhodes' idea of empire as a vent to relieve pressures in England. However, where Rhodes stressed population pressure, Hobson stressed the pressure of new savings seeking outlets overseas, and new customers.

2. Hobson, like Malthus, saw worsening conditions ahead. Hobson stressed underconsumption more, and land limitations less, than Malthus did - although each of them touched on both matters. Malthus saw no way out; Hobson saw England shooting its way out, at least for the foreseeable future.

Smith saw domestic capital formation growing due to saving, and making more jobs for workers. Hobson saw saving as detracting from consumer demand, making goods unsalable, dooming workers to joblessness. (Keynes, later, was to make his mark by showing, or purporting to show, that consumption and saving and investing may all grow together.)

Mill saw "scarcity breeding substitution," such that growing population would make new investment outlets to substitute capital for land, and make jobs for workers. Mill saw foreign investing as a desperate last resort, with very high risks and low returns. Mill thought of underconsumptionism as an exploded mercantilist fallacy, not worthy of serious consideration. Thus, Hobson and Mill were on different wavelengths entirely.

3. Find the words in the Glossary herein, or in Heilbroner, or your notes, or the dictionary, or the Palgrave Dictionary. I hope you have been learning new words as you went along. If not, start now!

4. Underconsumptionism is the idea that the circulation of money slows down because not all savings are invested; and savings are excessive due to the unequal distribution of wealth and income.

5. See Hobson, #3.

6. See Hobson, #6-8

7. See Hobson, #7.

Vertical integration is a term usually applied to corporations that acquire their own raw materials, and their own retail outlets, so they control production from beginning to end, and are self-sufficient and invulnerable to disruption. It may also give some parts of the vertical chain power to exploit other parts, e.g. a grain exporter exploiting farm suppliers. Mercantilism involves the same idea applied to nations. It often leads to warfare.

Clark

Defenders of proply + status quo strike back. Esp. vs. Marx & George & Wallace. Reshaped the discip. NCE

1. Distrib. out - allocation in.
2. Dynamics out - static analysis in.
Cycles, history out.
3. Trinity out - duality in. "2-factor econ."

4. Fuse land + K

- a. K fixed in g.
- b. Turnover glitch less
- c. Coexistence in, sequential relations out
- d. Demand-side valuation - no "frozen labor"
- e. K + land both fungible, & mutually convertible
- f. Trivializes L.V.
 - land is all agric.
 - agric. not important
- e. Land is man-made

5. Rent redefined as excess over o.c.
All factors can rent.

6. TRANSFAL

7. Can't redistribute wealth - just shrink pie

8. Interpersonal trans. are impossible

9. Endless open frontiers.

August 25, 2003

To: College of Humanities, Arts, and Social Sciences Faculty
From: Emory Elliott, Director, Center for Ideas and Society
Subject: **Nominations for Distinguished Humanist Achievement Lecturer**

In 1992 the Center for Ideas and Society inaugurated an annual lecture series to recognize and celebrate the achievements in scholarship or the arts of a member of our College faculty. It is once again time to request nominations for this honor.

The U.C. Riverside Distinguished Humanist Achievement Lecture award is presented to a colleague for a significant recent scholarly research or arts accomplishment or a series of such accomplishments, whether this is a recent book or a series of articles, a creative production, or a distinguished performance. If the accomplishment is a scholarly monograph or series of articles, the publication(s) should ordinarily be thought of as changing in an important (and perhaps even a permanent) way the nominee's field.

The intention of our series is to honor a significant recent scholarly or arts achievement or series of such recent achievements without regard to rank or length of service at the University of California, Riverside. We could celebrate a cornerstone as readily as a capstone. This distinguishes the Humanist Achievement Lecture from the Faculty Research Lecture award, since the latter is presented to very senior faculty for the accomplishments of an entire career.

We invite you to nominate for this award a member or members of the CHASS Faculty. Please indicate the nominee's name, department, and rank, and provide a brief description of his/her recent accomplishment(s). Supporting materials, such as reviews, a copy of the publication or creative production, or a recording of the performance, are also required. Works in progress or unpublished works are not eligible for this award.

The award will be made by the Center's Advisory Committee. It is expected that the successful candidate will give a lecture in Winter 2003 or Spring 2004 which explains the recent scholarly or arts achievement to his/her colleagues.

Please submit nominations and supporting materials to Laura Lozon, Center for Ideas and Society, 227 Highlander Hall C, before the **deadline, Monday, September 29, 2003.**

Clark

9.

Factor symmetry

Wicks ted - Shaw

all have input products

They exhaust TP - Euler

1.

Fusing ~~land~~ & K

→ Modules missing?

Review Terms

John Bates Clark and "Neo-classical" Economics

Around and after the time George wrote, Political Economy became a standard academic discipline. Several of its new practitioners reshaped the topic from the "Classical" form of Adam Smith et al., with its twin emphases on distribution and land. (They also changed the name from Political Economy to Economics.) Economics, in their hands, became limited to a study of "the allocation of scarce means among competing ends." Translated, that means focusing on efficiency (optimal allocation) to maximize the economic "pie," and not fretting about who gets the pie, or how we slice it - except as that affects efficiency. It also meant assuming a constant condition of scarcity.

In practise, that meant rationalizing the status quo, except for opposition to monopolies - not for their injustice, but their inefficiency. Distribution and dynamics were cut out; land was "disappeared" by fusing it with capital; 3-factor Political Economy became 2-factor Economics. The revised discipline is called "Neo-classical Economics."

Some leading figures in the "Neo-classical Revolution" whom we consider here are John Bates Clark, Francis Ysidro Edgeworth, Richard T. Ely, and Alfred Marshall. We then look at three figures of the post-classical era who do not fit the Neoclassical mold: John R. Hobson, Thorstein Veblen, and John Maynard Keynes.

Here are the Elements of Neo-classical Economics as found in J.B. Clark.

→ ① Fusing land and capital. Clark accomplished this by several devices.

a. His analysis is static. The quantity of capital (K) is fixed, which makes it just like land. Clark's capital is immortal, like land. There are no dynamics, except for turnover of capital, which Clark has occur smoothly and "glitchlessly" (and with no measurable period of turnover).¹ There is no capital formation - it all comes from the past, and is automatically retained for the future. The economic system is solely one of relations of coexistence, without relations of sequence. The economy is at rest, in a benign equilibrium. There can be no boom and bust problem. There are no Laws of Motion - no history, and no forecasts except continual improvement - cf. #6, below.

b. Demand-side valuation. The value of K is subjective: it depends solely on demand, unrelated to any cost of production. This makes it just like land.

c. Capital and land are mutually convertible; each is "fungible". The policy implication, pushed especially by Clark's colleague E.R.A. Seligman, is that taxes should fall uniformly on both land and capital, never on land alone as Henry George favored.

¹ Clark and his follower, Frank Knight, stressed this point heavily. In this short course, we must omit it. All the classical political economists, following Quesnay, had made turnover a key variable, a way of making a given quantity of capital combine optimally with given quantities of labor and land, to render the most service. The "Austrian Economists," contemporary with Clark, stressed turnover even more - and Clark and Knight attacked them bitterly for it. Clark's erasure of turnover from economics was a great disservice.

d. Trivializing or marginalizing land rents and values.

J.B. Clark and other NCEists do this in two steps:

i. Land is only important in farming; urban land values are negligible. Even in farming, land has become unimportant (Ely, Schultz).

ii. Farming is no longer important, anyway, in the urban "industrial" economy. George was just an "agrarian" or "populist," now obsolete and irrelevant.

e. The value of land is man-made, by cuts and fills, draining swamps, fertilizing the soil, etc. Private and public works (it doesn't matter which) are what enhance land values; Nature is uniform and sterile until tenured and developed by man.

f. Net result: "2-factor economics" (Labor vs. Capital)

replaced classical 3-factor Political Economy (Land, Labor and Capital). In this respect, Clark coalesces with Marx.

② Universalizing "rent." All incomes are unearned, hence are rent, and may be taxed. This is also Marx's view - an interesting commonality in supposedly polar, clashing ideologies.

③ Presumption of austerity. There can be no "free lunch": every good thing gained implies another good thing lost. Everything in life is a trade-off, and many of these are harsh or "dismal," as in Malthus: food vs. sex, jobs vs. the environment, inflation vs. unemployment, equity vs. efficiency, etc. Take your choice, but all the choices are bad. Anyone claiming otherwise is peddling a "panacea," and thereby condemns himself as being moonstruck. This attitude, we have seen, keeps rising to the top, and losing elections for those who peddle it to the voters.

Clark himself is less austere on this matter than successors in the modern "Chicago School." For Clark's sunny side, cf. #6.

④ Redistribution of wealth and income is futile and counterproductive, just as Malthus said, but for entirely different reasons. Clark rejects Malthus' distinction of land and capital. The new emphasis is that actual distributions are the same in all nations, regardless of public policies ("Pareto's Law"). Efforts to equalize or adjust distribution of the "pie" can only shrivel the pie by damaging incentives. (Sound familiar? What well-known pundits echo this canon nowadays?)

⑤ Interpersonal comparisons of well-being are impossible, so there is no way to justify egalitarian redistribution on the grounds of diminishing marginal utility of consumer goods. It is possible to say, however, that those raised in wealth need more than the poor, because of their greater learned capacity to enjoy good things (Clark borrowed this from Edgeworth and Pareto). This acquired characteristic is inherited.

⑥ Clark did venture into dynamics enough to say that new capital and technology save land and use labor, and continuously bring new land into the

market, so there is no scarcity of land, but an ever-growing demand for labor. (This evokes the optimism of Adam Smith.) Pushing back frontiers goes on into an infinite reservoir of raw land, creating ever-expanding opportunities to invest capital, produce more goods, and make jobs. This expansion includes military actions to displace, kill off, or dominate previous inhabitants (Frank Knight). (A later faction, called "Keynesian hawks," favored high military budgets to make jobs. One of these, Lawrence Klein, won a Nobel Laureate - from the same group that awards the Nobel Peace Prize! Life is full of ironies and inconsistencies.)

In Clark and NCE, there is no problem with conservation, the environment, or the ecology. Resources in their natural state have no value until and unless some private party owns them. It is the very act of establishing private ownership that gives resources their economic value. Thus, Clark allows for the growth of K, but has land grow in step with it. Obviously, this view held by NCEists alienates many modern environmentalists.

⑦ After 1936, when Macro was introduced by Keynes to cope with The Great Depression, static Neo-classical Economics faced a crisis. The solution has been compartmentalization of Macro (which deals with relations of sequence) from Micro (which remains static and Clarkian).

⑧ A corporation is just another business firm, to Clark. Smith's model of the world, based on atomistic individual owners, hardly needs modifying in a world of layered ownership, mergers and acquisitions and junk bonds. For someone who thought otherwise, see below under "Veblen."

J. B. CLARK - Questions.

1. Thomas Malthus and John Bates Clark both opposed "levelling" policies, but for very different reasons. What were their different reasons?
2. What historical Laws of Motion, if any, did John Bates Clark advance?
3. Karl Marx and Henry George, like all the Classics, saw K's value as limited by its cost of production. How did John Bates Clark change that?
4. Are land and K mutually convertible?

What did John Bates Clark say?

5. Is the value of K entirely subjective, or is it limited by its cost of reproduction?
6. Is land value a small or large fraction of urban values?
7. Summarize the several ways that John Bates Clark fused Land and K.
8. Clark disputed and rejected Henry George's reconciliations, but had his own optimistic forecast. What was it?
9. Was John Bates Clark a conservationist?
10. (Optional) Mill advocated peaceful redistribution of wealth through the ballot box; Marx saw a need for violent revolution; Clark opposed redistribution altogether. What were their respective reasons?
11. (Optional here.) With Edgeworth, Jevons, Walras, Clark, and other neo-classical economists, economics became static and "ahistorical."
 - a. What "Laws of Motion" of history were seen by Smith, Malthus, Ricardo, Mill, Marx and George?
 - b. How did static neo-classical economics cope with the Great Crash and Depression, 1929-40?
12. (Optional: this one is tricky.)

Many of the Worldly Philosophers warned of dire results if the MROR on capital falls too low to evoke enough new investing. Ironically, it was mostly the radicals and reformists who showed this concern. Organized wealth-holders and their spokespersons have focused on maintaining high levels of rents, and values of old, pre-existing assets. Explain why a low MROR on new investing helps support such existing values, and a high MROR works to lower them.

J. B. CLARK - Answers

1. Thomas Malthus opposed leveling because it would just encourage workers to spawn more children, doomed to starvation wages because of diminishing returns to labor, applied to fixed land. John Bates Clark did not see land as fixed. Clark opposed leveling because it might weaken incentives to work and save.
2. Clark's Micro model is mainly static, but he also wrote that K formation will effect an indefinite expansion of the land supply, to the benefit of labor. Note the polar opposition here to George and others who feared the effects of K displacing labor (e.g. farm machinery) from a fixed land supply.
3. John Bates Clark and other NCEists see the value of K as being subjective, like that of land, derived entirely from forecasts of its future usefulness. In their static model, costs of reproduction are irrelevant: capital already exists.
4. No. See "Land as a Distinctive Factor of Production," pp.55, 67-69, et passim.

John Bates Clark has them mutually convertible. When one buys land, the money used is K, and it "vests itself" in land, becoming land itself. In addition, outlays to develop land are what give land its value. According to Clark, Nature is uniform and sterile until tenured and developed by man.

5. The value of K can rise no higher than the cost of reproducing it. It can and does sink lower as it depreciates and obsolesces.
6. A large fraction. The Instructor should supply data on this point.
7. See #1 under John Bates Clark, subheadings a-f.
8. See #7 under John Bates Clark
9. No, Clark believed land was indefinitely reproducible. Clark's career spanned the height of the conservation movement led by Presidents T. Roosevelt, W.H. Taft, and W. Wilson, but it did not touch him.
10. Mill observed that land tenures are based on historical force and fraud, and have little ethical basis. He had faith in his powers of persuasion, and in representative government, to correct this gradually, using the tax mechanism.

Marx agreed about the origins of property, only he condemned all private property. He believed the owners would never accept any levelling by any method, and he never seems to have considered taxation as a device. He had no faith in persuasion, believing that those who own property also dominate education, religion, politics, and the media, and will always brainwash and dominate the voters. That leaves revolution, led by unions and a self-educated elite, as the only viable path to reform.

Clark liked the world much as it was, and devoted his career to keeping it that way. His only reform "cause" was breaking up monopolies, which disturbed him because they interfere with free markets, in which he placed his faith.

11. This is a good "Final Exam" question, too comprehensive to answer here.

12. The return on K varies inversely with land rents. Thus, a low MROR does not cut into property incomes, but transfers them from rewarding investing in capital to rewarding ownership of land.

It is optional with the Instructor how deeply to get into this topic, which may involve a little math.

Francis Ysidro Edgeworth

1. Edgeworth made heavy use of mathematics, coupled with cryptic, exclusionary prose, difficult or impossible to follow, addressed to a few specialists and sectarians, thus "dehumanizing" economics (Heilbroner, p. 176). This approach has been criticized as "arid, sterile, and mechanistic" - a misapplication of otherwise reasonable and useful mathematics. Heilbroner says it enjoyed "immediate" success among academicians (ibid.). The immediacy is arguable, but the long-term acceptance among academic economists is a fact of life - an unhappy fact, for many. In this course we will avoid it. We will not avoid math per se, for math is useful and even essential in its place. There is a difference, though, between use and abuse.

2. To Edgeworth, every person is a "pleasure machine," maximizing pleasure and minimizing pain following mathematical rules. This mechanistic outlook borrows from physics, and is "aesthetically pleasing" and satisfying in a limited mathematical sense: one reasons from axioms to firm conclusions. Critics say that neither the axioms nor the methods fit the human condition, and label such procedures "scientistic" (phony and pretentious) as opposed to truly scientific. Bentham

3. In free markets with defined property rights, and a degree of competition (Edgeworth was tolerant of property-based monopolies), each person receives the maximum net pleasure possible. You cannot compare one person's pleasure with that of another, so redistributive policies like Mill's have no scientific basis. However, all voluntary exchanges are mutually gainful ("win-win" deals, we say today). Privatize all property, repeal regulations, and the market will sort things out optimally. Look familiar?

4. The main obstacles to free markets are limits on the full power of private owners to administer and dispose of their property, and labor unions. The unions will self-destruct. (Cf. Marx, who forecast capitalism would self-destruct by generating the environment for labor unions.)

5. Those of high birth and inherited wealth and male gender are better pleasure machines than others, so existing class divisions and entitlements to property, based on birth and gender and status, are for the best. "Men were better equipped to run up their psychic bank accounts than women, ... (Thus, Edgeworth) justified those divisions of sex and status one saw about him in the living world." (Heilbroner, p.175). In Edgeworth's own words, he favored "the privilege of man above brute, of civilized above savage, of birth, of talent, and of the male sex."

Edgeworth's ally Pareto, a supporter of Mussolini in Italy, was a more complete MCP even than Edgeworth, and actually published the following.

✓ "When the suffrage has been given to all men, including madmen and criminals, when it has been extended to women, and, if you like, to children, it will have to stop. One cannot go any lower, unless the suffrage is extended to animals."

Prop. qualif. on voting. Prop. 218

Was that just the Zeitgeist (temper of the times)? Not exactly: remember that J.S. Mill, Henry George, G.B. Shaw, and other contemporaries were feminists. It is a piercing commentary on economists that much of “gateway” economic theory, as taught today, hallows and follows Edgeworth and Pareto, and downgrades the feminists.

6. Although personally shy, Edgeworth boldly persecuted radicals: Hobson for heresy, and the classical Cairnes for allegedly weak mathematics. Both Hobson and Cairnes favored redistributing wealth, and many have suspected Edgeworth of political bias. He was not overtly overbearing, like Marx, but occupied a position of quiet power at Oxford with which to reward friends and punish foes from behind closed doors.

7. Self-contradictions of Edgeworth

A. In opposing “Robin Hood” policies, Edgeworth holds that you cannot make interpersonal comparisons. Thus, he refutes the “utilitarian” idea that the rich person will miss \$100 less than the poor person will appreciate getting it. In this, he overlooks two points:

i. In vindicating unequal distribution of wealth, Edgeworth himself makes interpersonal comparisons, by claiming that men and the rich are more sensitive to pleasure than women and the poor.

ii. If you cannot justify redistributing wealth, neither can you justify keeping it the same. You cannot justify anything. Edgeworth’s strategy is simply to put the burden of proof on those favoring change, and then make proof impossible.

B. In opposing Georgist land taxation, Edgeworth says it

will force premature building; but also that it will slow down building. Like Malthus, he can hold two opposing positions at the same time, and never reconcile them.

C. Edgeworth’s economics presupposes complete rationality, and even a high degree of mathematical expertise, on the part of all producers and consumers.

✓ Yet his politics declares that women, and the poor, and suppressed ethnic minorities, are all too stupid to vote.

8. Edgeworth’s conflict of interest.

Edgeworth was a member of the “Protestant Ascendancy” of English landlords in Ireland. (His mother, an Ysidro, was of Spanish descent, but the political and social penalties for being Catholic in 19th Century Ireland were severe.) Being male, under the laws of Great Britain he was heir to wide lands with tenants. It is hard to avoid inferring that his views on both economics and feminism were determined by his socio-economic status which, as Ricardo wrote in 1817, “is always opposed to the interest of every other class in the community.” Marx might have cited him (had Marx lived that long) as a textbook example of a person whose ideas are determined by his own material circumstances.

9. Edgeworth on rationality

✓ Edgeworth began the institutionalization of the assumption that we are all "rational" economic agents, or "economic men." Critics call this unrealistic. For example, in California it is estimated there are 630,000 people who are "severely mentally ill." In the U.S.A., there are an estimated 5.5 million "compulsive gamblers" (L.A. Times, 22 November 99, pp. A1, A11). In Edgeworth's world, the profession of Social Work would not exist. There would be no drug addicts, alcoholics, retarded persons, cripples, senile and infirm people, orphaned infants, incompetent minors ... thus solving half our problems by assuming them away.

Also, no emulation. J.G. Boswell; Boone Pickens;

F. Y. EDGEWORTH - Questions

1. Contrast the economic ideas of John Stuart Mill with those of F.Y. Edgeworth
2. What was Edgeworth's idea of the role of math in economic analysis?
3. By what set of public policies would Edgeworth maximize social welfare?
4. Cf. the forecasts of Marx and Edgeworth on the role of labor unions.
5. How (to whom?) would Edgeworth assign entitlements to property before turning economic life over to market competition?
6. "Compartment-mindedness" is holding unreconciled contradictory beliefs at the same time. Malthus and Edgeworth are examples. Explain.

F. Y. EDGEWORTH - Answers

1. John Stuart Mill and Edgeworth both favored relying on free market forces to guide the allocation of resources, and the combination of factors in production, but Mill would "redistribute" wealth and incomes via taxation. Edgeworth thought that impossible, the taxes would interfere with incentives. He also thought it undesirable, or at least unprovable, as an approach to justice.

As a humanitarian reformer, Mill was ahead of his times; Edgeworth was behind his, in the sense that he resisted movements toward democracy. Neither was a "man of the people," like Henry George, but Mill was a seasoned administrator, and also served in Parliament.

2. Methodologically, John Stuart Mill was a logician, who reasoned through the careful definition and use of words; Edgeworth was a mathematician who reasoned through the use of abstract symbols and the rules of calculus. As a social philosopher, he assumed that other humans, acting as "economic agents," also reason mathematically.

3. By privatizing most resources, and giving the owners full power to manage and dispose of them, free of social regulations. Thus he "bucked" the mainstream trends of social thought of his day, and the following years clear up to the Reagan Revolution after 1980. Today his views are again popular: "Deregulation" and "Privatization are the catchwords of the day.

4. Edgeworth thought unions would self-destruct; Marx that they would grow stronger, take over the state by force, and dig the grave of capitalism.

5. Edgeworth would firm up all existing private property rights, removing any residual social obligations. (He would not try to start with a clean slate, as in the Biblical Year of Jubilee, or in the recent Russian distribution of corporate stock vouchers to all citizens equally.) He would privatize all resources currently either held in common, or untenured, or held by government agencies. Then he would remove most or all regulations, price controls, subsidies, etc.

6. Malthus believed that land scarcity would prevent supply from meeting the demand of all those who are born. At the same time he believed demand would be insufficient to buy all the goods produced.

Re Edgeworth, see #7.

Richard T. Ely

+ Social Gospel.

1. When young, Ely developed a reputation as being pro-labor. It is odd how early reputations endure, as people change. In later life Ely flip-flopped completely. This is partly a tribute to the power of witch-hunting, to which he was subjected – see #5, below.
- ✓ 2. Ely was educated in Germany, like many of his contemporary economists. He learned to favor Bismarckian “Managerial Socialism” (paternalism and dirigisme), i.e. intervention in the free market; he opposed “Distributive Socialism” (egalitarianism via taxation in free markets) as framed by Ricardo, Mill, and George. Dirigisme sans egalite, the French might call it, and associate it with the prince of Mercantilists, J.B. Colbert (q.v., supra).
- ✓ (Bismarck’s brief feud with Rome (the *Kulturkampf*) also endeared him in this era to many intellectuals, most of whom were non-Catholics; and to nativist Americans who feared the growing numbers of immigrant Catholics, especially the rebellious, politicized, unionized Irish.)
3. Ely’s career was launched by Daniel Coit Gilman, President of Johns Hopkins; and Andrew Dickson White, the President of Cornell. Both Gilman and Ezra Cornell, founder and angel of Cornell University, had earlier scores to settle with Henry George. (For details, see G&H, pp. 72-75, 83-88.) Ely, as a protegee, inherited this feud.
- ✓ 4. Ely founded the American Economic Association, 1885. It still reveres his name and ideas. Wealthy Abram Hewitt (the man who threw the 1876 presidential election from his client, Samuel Tilden, to Rutherford B. Hayes) paid the bills, saying “The problem is to make men who are equal in liberty content with inequality in property.” Thus was launched the organization of professional economists. The next year, Hewitt ran for Mayor of New York, a job he did not want, saying “I am a candidate for Mayor for only one purpose. I regard the election of Henry George as Mayor of New York as the greatest possible calamity...” Hewitt went on to become Trustee of Columbia University, which then hired J. B. Clark, q.v. Thus, both J.B. Clark and Richard T. Ely were funded by Abram Hewitt.
5. In 1894, Ely was persecuted and threatened with firing for alleged “socialism” while a professor at The University of Wisconsin. This has kept convention-bound economists from realizing that Ely had become a supporter of unbridled robberbaron capitalism.
- ✓ 6. World War I and its preludes made German culture less popular. Ely had to fall back and regroup. In 1920, he founded a new discipline he called “Land Economics,” with an Institute and a Journal funded by major land-grant railroad corporations. He advanced the following major theses:
 - ✓ a. Land is the same as other factors of production. (This tracked J.B. Clark.)
 - ✓ b. Land has little value, and that little is falling toward zero. (This tracked Francis A. Walker.) Heilbroner has bought into this assumption, too.

- c. The land market works efficiently.
- d. Distribution of landownership is very equal.
- e. Tenancy, as opposed to owner-operation of land, is a good thing. 1/3 or more of farms and other businesses should be tenants.
- f. Taxes must not be raised without compensating landowners in advance for the presumed loss of value.
- g. Sales and payroll taxes should rise; property taxes should fall.
- h. "Land Speculation" (in the sense of withholding land from the market) is socially beneficial. The land is "ripening" into a higher use, like timber or fine wine.
- i. The costs of buying and then holding land (interest and property taxes, mostly) are "ripening costs," are socially useful, and deserve a reward.
- j. Taxes on ripening land tend to "force the market" (cf. Edgeworth) and cause premature development. (This doctrine was revived in 1957 by Spiro Agnew, then a Maryland Assemblyman, and has spread widely. In California the Agnew legislation is called the "Williamson Act" for farmland, and the Timber Preserve Zone (TPZ) Act for timber.)
- k. High land prices are desirable because they promote capital formation. (Instructor will present opposite thesis, that low saving in the U.S. results from cashing in on rising land values, e.g. under homes, to pay for current consumption.)
- l. "Conservation" is a good thing, and is served by holding land out of use. Logging lands in northern Wisconsin is a prime example of premature use; the "cutovers" have no value. (Instructor will give data on land values in Vilas County, Wisconsin, one of the cutovers, now a prime resort area.)

R. T. ELY - Questions

1. J.B. Clark and R.T. Ely were key figures in the campaign to discredit classical political economy and replace it with neoclassical economics. Explain their main points.
2. Distinguish "Managerial Socialism" from "Distributive Socialism." Which Worldly Philosophers favored which? (Hint: "Managerial Socialism" is exemplified by Bismarck's Germany.)
3. Marx observed problems in capitalism and wanted to destroy it or see it destroy itself. Reformers like Mill, George, and Keynes observed problems and wanted to solve them to save capitalism, or make it work better. Clark, Edgeworth, and Ely observed the same phenomena and defended the system as is. Briefly state their different positions.
4. President Gilman of Johns Hopkins, and Mayor Abram Hewitt of New York City, played key roles in Ely's career. What were the roles?
5. Ely founded two leading professional organizations. What are they?
6. Ely wrote about "land economics." Did this put him at odds with J.B. Clark, who denied that land is a distinctive factor of production?
7. Ely raised large funds to study land economics. What problems did he identify and propose to study and solve?
8. Did Ely lean towards anarchism (lower taxes, less government)?

R. T. ELY - Answers

1. See J.B. Clark, esp. #1-2, and R.T. Ely, #6a-6k.
2. Managerial socialism is when government agencies administer publicly-owned resources and businesses, AND regulate the use of private property. An example is a city water supply system. The purpose is to raise the value of privately owned property.

Distributive socialism is when government taxes privately held property, and spends the taxes for common public functions, including services to people. The property may be controlled and managed privately.

3. This is a good final question, too long to answer here.
4. Gilman founded the first Ph.D. program in economics in the U.S.A.; his graduates dominated the discipline during 50 formative years of NCE, 1880-1930. Ely was his first hire.

Hewitt bankrolled the struggling early American Economic Association that Ely founded in 1885. The next year Hewitt ran for Mayor of New York for the sole purpose of keeping Henry George out of the job. Ely was not one to bite the hand that fed him, and joined J.B. Clark in reshaping the discipline so as to discredit George.

5. In spite of writing about land economics, Ely tried to show that land is NOT distinctive, but is just like capital, and even like labor. He and Clark were allies.
6. The purpose of Ely's work in land economics was to show that the market works very well. The main problem he saw was the property tax on land; his solution was to raise sales taxes.
7. Ely did not object to big government, nor to taxes, so long as they were not property taxes. He favored shifting to sales and payroll taxes. He would never identify himself with anarchism, which in those days meant bomb-throwing.

Thorstein Veblen

1. Veblen's style

Veblen plays the ``Man from Mars'': a sardonic observer of life, only incidentally a participant. This is a form of objectivity, although inevitably colored by his own values. He is one of the great satirists, like Jonathan Swift before him, and Peter Sellers and Woody Allen after him. He is also a skilled economist who pokes fun at his own tribe.¹ His dry wit can be enormously funny, once you realize he is poking fun at human follies - yes, even your own. If he simply irritates you, you probably need his message. A great value in Veblen is to stretch your mind, or ``Emancipate it from the subtle tyranny of circumstance," as Mitchell put it. He releases you to be creative, to be yourself - not by urging you, but by setting an example, or ``walking the walk."

1. Veblen and the icons of ``consumer sovereignty" and individualism

Veblen rose to early fame with The Theory of the Leisure Class, 1899. He razed the icon of ``consumer sovereignty," the one value venerated both by NCEists, and underconsumptionists like Hobson and Marx. Veblen showed how much of our consumer ``needs" are just ``competitive emulation," and ``conspicuous consumption" - self-validating efforts to keep up with the Jones's in an endless, fruitless spiral of waste.

. Nature of economic man.

Veblen stressed that mankind is social, custom-bound, and less than rational, not like the robotic and calculating ``pleasure-maximizing machines" of Edgeworth. Veblen discussed things like:

tradition,
ceremony,
symbolism,
hypocrisy,
advertising,
cosmetics,
customs,
emulation,

¹ Two other satirical economists are Stephen Butler Leacock and John Kenneth Galbraith, both born as Canadians. If you like dry wit, they are great; as deep thinkers, neither matches up to Veblen.

team spirit,
the family,
the clan,
the military band,
social standing,
folkways and mores,
fads and fashions,
group values,
image,
"vicarious leisure,"
cults,
credulity,
frauds,
ethnic loyalties,
personal ornamentation

- the stuff of real life. He did this from the perspective of an academic insider, who knew perfectly well what socially correct authorities like Clark, Edgeworth, and Marshall were trying to say. They could not blow him off as someone who just didn't get it. He got it, all right, but he didn't buy it. There's a world of difference.

The next economist to take that view was to be Keynes, who laid great stress on the "animal spirits" of investors as a cause of boom or bust.

2. Institutions

Veblen disagreed with the neo-classical assumption that each individual is independent, autonomous, and endogenously motivated. He saw mankind organized into "institutions," like the family, village, church, nation, bar, party, army, hunt club, country club, lodge, corporation, union, police force, bureau, service, college, estate, trust, club, coop, cartel, professional association, etc., each with its own internal logic, loyalties, values and structure. Veblen's followers today call themselves "Institutionalists." It's not that Veblen opposed individualism per se: he was the most eccentric and inner-directed of individuals himself. Rather, from that perspective, he was able to see how group-oriented most other people are.

Veblen especially deplored the failure of neo-classical economists to deal with corporations. He correctly foresaw that this form of absentee

ownership would grow to dominate the economy, and overpower many governments; and that This makes consumption another kind of disequilibrating ``positive feedback," one that can make life an endless rat-race. It can make any population, however small, run up against Malthusian limits (a point stressed by ``green" parties today, but neglected by Veblen himself). However, there was no hypocrisy in Veblen: he ``walked the talk," living in penurious self-denial and defiance of conventional codes of required minimum levels of expenditure on dress, shelter or landscaping. He was not a hermit, though: women apparently pursued him.

(3) The Indignity of Labor

Having attracted world attention by mocking conspicuous consumption, Veblen moved on to more serious matters. Workmanship and engineering are useful and functional; rent-taking is at best leeching, and at worst predatory, e.g., in forming monopolies like OPEC, or seizing public lands for private gain. However, the values of most people are backwards: they admire predators, and see little dignity in labor. This is a throwback (atavism) inherited from a tribal past, where warlike leaders were useful. Veblen obviously thinks we should get over it. His last book, Absentee Ownership, makes that clear; but he is not going to risk his neck by leading the way.

4. Submission of the proles

Veblen asked: why do the exploited proles tolerate a leisure class riding on their backs, and cooperate in their own exploitation? Why do they even consider voting for billionaires who run for office? Why do they respond favorably to political ads, when they know the politicians have to sell themselves to pay for the ads? Why do they vote to disenfranchise themselves (as in California's Prop. 218, 1996)? Why do they let Congress have the IRS give loopholes to property income, and raise taxes on payrolls?

Veblen found the answer in a throwback to primitive times, the admiration for predatory traits over workmanlike traits (Veblen came from Viking stock). Labor is undignified; common folk who do useful things are awestruck by the leisured. Wages must be paid to overcome the indignity of work, rather than its irksomeness. Somewhat curiously, he does not consider the possibility that the exploited classes are simply too stupid to defend their own interests, and are easily manipulated by windbag politicians hired to confuse them.

The poor emulate their exploitive masters, instead of organizing to rebel against them as predicted by Marx. Thus, society tolerates and submits to its leisure class, the rentiers. Is he just taking a cheap shot at reformers, like a common hate-radio talkshow host, or does he disapprove of this emulation? Probably the latter. On the surface, he is only an amused spectator, recording our habits from afar, like a scientist watching lab mice. Yet, his mockery has such a bite, readers sense he is trying to make us examine ourselves.

5. Mocking the clerisies, academic and churchly
Veblen did not spare his academic peers from mockery, which did not help him on his way to promotion and pay. The academic discipline of economics, he wrote, is at best ornamental and hidebound (a view later shared by President Harry S. Truman). At worst it is venal and hypocritical, rationalizing leeching and preying, by confusing these with workmanship or saving (a view later shared by LBJ's Labor Secretary Ray Marshall, a Veblen disciple). Veblen tossed his barbs mainly at the neo-classical economics of Clark, Edgeworth, Marshall and Ely, regnant when he wrote.

Ely and Clark both were visible as churchmen. Veblen likened the faults of academic economics to those of organized religion, thus alienating the clergy too - while endearing himself to anti-clericals.²

6. Corporations

To Clark et al. a corporation is just another "economic agent" or "firm," following the same rules as Adam Smith's atomistic proprietors, protected by the 5th and 14th Amendments, properly enjoying the rights of actual persons, along with immunities not enjoyed by actual persons. To Veblen that is nonsense. A corporation, he wrote, is a combination of properties working in concert, unavoidably amassing great market power. It can stiff its creditors and pensioners by declaring bankruptcy, while its owners remain billionaires. Its officers are nearly immune from legal responsibility for actions of the firm. It is a new

² Veblen did not by any means originate anti-clericalism. The Founding Fathers were skeptical of churches in politics, hence the First Amendment. Adam Smith in 1776 wrote scathing attacks on the state-supported churches of Europe. Atheism, Agnosticism, Deism and Unitarianism are probably weaker today than they were 200 years ago. No modern U.S. President would show the anti-clericalism of Washington, Jefferson, or Franklin. In 1876, the Republicans had their presidential candidate, James G. Blaine, nominated by the most noted Atheist speaker of the era, Robert Ingersoll, who was also a successful Republican politician. The modern counterpart would have been having Madalyn O'Hair (while she still lived) nominate Bob Dole or George W. Bush.

and menacing form of property, he wrote in 1904, that does not fit nicely into free market theories. It's a new ball game, he said: let's deal with it.

For many years, those economists called "institutionalists" - followers of Veblen - did deal with it. 93 years later, however, with transnational corporations bidding to rule the world, more and more economists, following NCE rules, are shutting their eyes to the matter.

Veblen especially deplored the failure of neo-classical economists to deal with corporations. He saw them as fundamentally being combinations "in restraint of trade," as the law puts it, i.e. monopolistic conspiracies. He correctly foresaw that this form of absentee ownership would grow to dominate the economy, and overpower many governments; and that corporate managers would often dominate the nominal owners, the shareholders.

Veblen laid heavy stress on the counterproductive aspects of business leadership: on monopolies, cartels, unearned income, absentee ownership, business bureaucracy, false advertising, and exploitation of credulity, ordinary lobbying, "deep lobbying" (supporting thinktanks with anti-social agendas), and campaign contributions.

7. Laws of Motion.

A. Secular motion. Veblen disagreed with Marx that proletarians organized in labor unions would dig the grave of predatory, robber-baron capitalism. Rather, those who understand machinery and are production-oriented engineers and technicians would slide into control, rebelling against financiers who like to choke off output to raise prices. Veblen's dismissal of consumer sovereignty is consistent with his apotheosis of engineers, whose professional training teaches them they know best what is good for consumers.

The descendants of yesterday's buccaneers would become mere "ornamental functionaries," like ancient French do-nothing kings (*rois fainéants*) who lost power to their ministers and mistresses. Time soon revealed that Veblen had overestimated the leadership potential of engineers. In public works, it is true, civil engineers have great authority, including the power to get away with huge cost overruns. In many corporations, managers and bureaucrats and accountants have done what Veblen thought engineers would do, dominating both the customers and the nominal owners, the shareholders. To Veblen's credit it was his disciples, the "institutionalists," who exposed this evolution and rubbed everyone's noses in

it. Today, computer programmers have joined this power elite. Who's next?

B. Cyclical motion. Veblen had a cycle theory, but Heilbroner does not deal with it. Like Marx and George, Veblen essayed an explanation of crashes and depressions, but did not persuade many others he had it all together. At least he tried, unlike the NCEists. One of Veblen's students, Wesley Mitchell, pioneered intensive statistical study of cycles, and founded the National Bureau of Economic Research. Mitchell, among others, considered Veblen the father of cycle research.

8. The free market is filled with wastes and irrationality. These are inherent in human nature, even in the absence of state-induced wastes. Veblen echoed, in a way, Ben Franklin, who said we complain about taxes, but we are taxed more by our own follies than by the government.

9. Veblen showed one can thrive as a nonconformist, even in the conformist society of his times. In fact, Veblen was more accepted in his supposedly conformist age than he is in ours. Then, there were still many people who appreciated "Emancipation of the mind from the subtle tyranny of circumstance." Today, economic doctrines and methodologies have become routinized and stylized in the name of "positivism." Free-thinking and direct observation like Veblen's are scorned as "mere sociology." Edgeworth is more the model for current styles in economics, especially in the "Gateway" courses.

Veblen also succeeded by leaping the bounds of professorial readership, attracting a mass audience. Veblen did this from inside the academy and thus could not easily be excluded, as outsiders like George and Hobson and Marx were. However, there are other weapons to use against perceived threats to the status quo. Read on.

10. It has become customary to snicker at Veblen, as Heilbroner does, for alleged extra-marital affairs. This may say more about the snipers than their target, since some others, like Ely and Keynes, were equally or more active outside the conventional bounds of matrimony, without drawing that kind of gratuitous personal slur. Their work did not threaten corporations and conventions as directly as Veblen did. *Ad hominem* attacks are a cowardly way to discredit ideas by slurring the bearer while ignoring the ideas. And, alas, people are stupid, salacious and vindictive enough to fall for it.

Actually, much of the gossip about Veblen's affairs has turned out to be unfair and inaccurate, according

to the latest biography by Henry and Elizabeth Jorgensen. The ``many women'' in his life turned out to be one woman, who became his second wife as soon as his first wife, who had abandoned him, freed him to remarry. For years, he might have written Engelbert Humperdinck's great hit, ``Please Release Me.'' He then adopted the two daughters of his second wife, and was a responsible, generous and caring stepfather - he put them through college and on into graduate school. The two stepchildren, whom I knew through a family connection, respected and loved him, took his name, and venerated him until their dying days.

T. VEBLEN - Questions

1. Explain why Veblen's ``competitive emulation'' is an example of positive feedback.
2. How did Veblen feel about consumer sovereignty?
3. How did Veblen feel about engineers?
4. Why, by Veblen, do the working proles not rebel against the rentiers?
5. What worthy ``causes'' did Veblen espouse?
6. What did Veblen think of his own profession, economics?
7. How did Veblen feel about the ``economic man'' of NCE?

8. List six or more irrational aspects of economic man as painted by Veblen.

T. VEBLEN - Answers

1. With competitive emulation, more consuming by A lowers the welfare of B, who must consume more material goods to recover his position. This in turn lowers the welfare of A, who reciprocates, and so on until one is exhausted.

If both of them are able to consume more by exploiting others, neither A nor B will be personally exhausted from working, and exhaustion becomes a social phenomenon, involving drains on natural resources.

Competitive emulation may also take the form of acquisition: the biggest balance sheet, the vastest lands, the toniest neighborhoods, the most power. The old neighborhood of one's youth suddenly seems forlorn and déclassé when one's peers move on to better places and leave you behind. The "wrong" people move in, and "there goes the neighborhood." People pay breathtaking premium prices for location, and even for a Beverly Hills zip code.

2. Veblen thought most consuming is dominated by the drive to gain or maintain relative social standing, rather than the individualized "felicific calculus" of Edgeworth. He thought true satisfaction comes from workmanship (although it was not his style to put it in such a homely, preachy manner).

3. Veblen apotheosized engineers. He was as uncritical of them as he was critical of almost everyone else. Engineers were the leading workmen of modern society, imbued with an instinct of workmanship, oriented toward producing goods. He saw captains of industry and financiers and lawyers as predatory and suppressive, oriented towards rigging the market to maintain overpricing, and monopoly profits, by limiting the volume of production. This led to an ideological conflict. Engineers would finally win, leading to an economy of abundance.

4. The proles submit to the rentier, who exploits them, out of grudging admiration and emulation. This is a throwback to early tribal cultures when warlike, predatory leaders were useful.

5. Veblen espoused no causes. He had no leadership qualities nor social graces.

6. Veblen mocked his own profession, especially his contemporary NCEists, just as savagely as he did the rest of society. He saw their work as a ceremonial function to cover up the sins of the lords of creation.

7. Veblen considered the NCE "economic man" as an imaginary construct of theoreticians blinded by mathematics. He observed real behavior swayed by more primitive, atavistic emotions, and by envy.

8. See Veblen, #8.

J. M. Keynes

1. Dynamic Economics

a. Neo-classical economists had deleted dynamics from the subject, as part of their suppression of Marx and George, who had stressed it. To undercut George in particular, they treated capital as though it were the same land, fixed and never turning over. Veblen and Hobson had tried to revive dynamics, but they were shoved into the "underworld" of economics. Keynes, however, was very much the insider, a "Brahmin" of the Establishment, veddy British and Cambridge and highbrow society and upper crust and arty. He probably didn't know a hacksaw from a hammer-claw, but he was good at managing money, which Brahmins respect.

b. Jevons, a proper member of the right set, had discussed cycles way back in 1875, but was acceptable to Brahmins because he assumed the causes of instability were exogenous, i.e., not the fault of "the system." Jevons blamed sunspots, an hypothesis that died with him in 1882. Neoclassicists like Clark, Ely and Marshall, writing later, simply ignored cycles. Critics from "the underworld" were more worrisome: they said cycles were endogenous and "systemic," i.e. products of "the system" itself. This was unacceptably critical and threatening. Keynes was the first Brahmin to find faults endogenous to the system, and get away with it.

2. Demand-side Economics

a. Keynes developed a theory in which production and employment are highly responsive to "aggregate demand," so lack of demand causes depression.

- i. Marshall's demand (as in his theory of supply and demand) is just partial demand, i.e., demand for one commodity. If one demand goes down, another goes up: their sum (he said "aggregate") remains the same.
- ii. Keynes' aggregate demand is the sum of all income-creating demands. It has three main parts: consuming, investing, and government spending (C, I, and G). Investing is the use made of savings. Note well, though, that it is just NET new investing, which means actually paying people to work and produce capital. It does NOT include buying existing assets, because when A buys and B sells, the investing done by A is offset by the DISinvesting done by B.

Inc. -
creating

Similarly, Consuming means NET consuming, i.e. buying things that are newly produced.

If consumer A buys what B owns already, the consuming of A is offset by the DISinvesting of B.

iii. Consuming is mainly a function of income; it is passive and reactive. Investing is autonomous and volatile, and drives the Keynesian system. When it fails to recirculate all savings, demand falls below what is needed to maintain incomes at the prior level. Less income means less consuming; less consuming means less income; ... down, down, down ... frightening!

iv. Government spending is assumed all to be income-creating. You can think of examples where it is not, but we will pass them by here. Note, though, that it is only the excess of government spending over taxes - the deficit - that is a NET rise of spending. This has been a complex and controversial matter, with attitudes changing radically over time. I will not lay it out here, but outline it in class.

b. Rejecting "Say's Law."

i. The pre-Keynes view was that general gluts are impossible, because "supply creates its own demand." This was called "Say's Law" after J. B. Say, a French economist. Ricardo and Mill agreed; so did the neoclassicals, if they thought about it at all.

ii. Keynes took up the previously discredited "underconsumptionist" or "over-saving" thesis of Marx and Hobson, and said people might hoard their savings, thus depleting the circular flow of income and spending. Keynes made this previously "underworld" idea suddenly respectable. Marxists revere him for this. People who used to think of his "Bloomsbury set" as effete decadent snobs putting on airs, began calling him "Lord Keynes," and praising him and his set. Aristocrats are judged by different standards: why not make the most of it? If Veblen had lived that long, he might have died laughing.

iii. Keynes revived the idea of "positive feedback" but he and his followers called it a "vicious downward spiral." Less spending meant less income, less income meant less spending, and so on down to catastrophe.

Most economics, remember, stresses "negative feedback," so the system is self-regulating. In the chaos of the Great Depression the system was not regulating itself well, making eager listeners for Keynes' message about the vicious downward spiral.

iv. Keynes' solution, in simplest terms, was "reflation" (stop falling prices), and not to worry about the risk of a little inflation (rising prices).

The prospect of rising prices is actually beneficial: it prompts people to spend faster, turning the vicious downward spiral into a "virtuous" upward spiral.

Tied in w/ Quad
anno.

(C) Downplaying the interest rate.

A variation of Say's Law is that over-saving cures itself by pushing down interest rates, which stimulates borrowing and investing. Thus, the interest rate (i.r.) is the price that equates the supply of investable funds (saving) with the demand for them (investing).

Keynes observed in 1936 that the i.r. has fallen all right, but for a while this failed to stimulate investing (p. 270). He declared we were in a state of "chronic stagnation" (see #4, below). He looked for another equilibrator (§5, below).

(3) Distribution of income and wealth.

a. Neoclassicals were unconcerned with distribution. Inequality was no problem for them, and they saw no difference of earned and unearned income. Keynes attributed over-saving in part to unequal distribution just as Hobson had (q.v.). [Heilbroner gets this backwards (pp. 265-66).] To correct this, Keynes favored personal income taxation with graduated rates, and corporate income taxation as well; logically, he would have opposed consumer taxes, although he stressed it little.

He carried his advocacy of consumption so far as to justify waste. Maybe he was just spoofing to make a point, but many followers took him seriously, and all his critics did, panning him as a "waste economist." ✓ He also undervalued conservation and the environment, which later lost him lots of support after about 1970.

b. Keynes favored raising wages in order to equalize income distribution, and raise demand. This partially revived the classical interest in distribution among factors of production (land, labor, capital).

c. To stimulate investing, Keynes favored policies to raise the MROR (the marginal rate of return on investing in new real capital). Raising wages implies lowering the overall returns to property, i.e., lowering rents on land, and quasi-rents on old capital. Thus, Keynes' policies would discriminate against land and old capital, in favor of labor and new capital even though he never said so explicitly.

✓ Entrepreneurs liked his policies, which flourished in the 1960s under the name "business Keynesianism." The stock and real estate markets stayed down, while national income and employment soared, and we formed new capital rapidly.

4. The "mature economy" notion.

Keynes thought we were running out of investment opportunities. The old geographical "frontier" was closed. Keynes' American apostle, Alvin Hansen, combined Keynes with the American "Turner thesis" about the closing of the frontier, and saw an end to investment opportunities. In technology, we'd gone about as far as we could go all the great inventions had been invented, what more could there possibly be after the automobile and the radio? Population was levelling off, limiting demand. We were approaching a "stagnant" private economy, stuck on dead center. See H's three-point summary, p. 274.

This reminds one of the gloomy forecasts of Malthus, and Mill's forecast of a coming "static state," and Marx's forecast of a falling rate of profit. In the midst of the Great Depression it seemed more plausible than it looks today: people have always overgeneralized from the immediate to the remote future (observe the stock market, for example).

5. Keynes' solution: prime the pump (p. 275).

Keynes had bad news (\$4) but he also had good news: a benign solution. If private investing failed, the way to maintain adequate autonomous spending was for government to take up the slack, and raise G by running a deficit. Also, the government should "subsidize private investing."

a. Private investing. This took several forms: guaranteeing private loans, lending below the market, down-taxing new investing.

same as H.G.

b. Public investing. Government should also invest directly, on its own account, by building public works, using borrowed money. Many major dams and aqueducts in the west, for example, were built under this policy and philosophy: Hoover Dam, Shasta Dam, Friant Dam and the Friant-Kern Canal, Grand Coulee Dam, Bonneville Dam, etc. Government became the "borrower of last resort," for those unsatisfied with private investment outlets.

Higher investing would raise incomes; higher incomes would raise consuming, would raise income, would raise consuming ... a "virtuous upward spiral." Keynes called this the "multiplier" effect; the name has stuck. The idea has a lot of allure: the good that you do directly is multiplied by the stimulus it gives others to do likewise. Whether one's passion is doing good or wielding power, "the multiplier" gives leverage to anyone in the driver's seat.

c. Public debt and the banks. Government bonds became the major investment of the private banking

system, and have remained so. This is not an unmixed evil. It means the assets of banks are a lot more stable than they were before, when banks went overboard for speculative real estate.

- d. Political success. Keynes told President FDR and his

New Dealers why they should do what they had started to do anyway. FDR called it "priming the pump" (a rural metaphor that folks understood in the 1930s). Today they call it "jumpstarting" (a tired metaphor now time for a new one). Keynes called it "the multiplier."

Neoclassicals had been preaching a dismal trade-off: to stimulate investing we must consume less, and labor must accept lower wages. Keynes said No! We can have it all. Consuming, high wages, and capital formation are complements, not substitutes. It was a winning formula politically, and has been used by winning candidates of both parties ever since including those who curse at the name of Keynes.

- e. Legacy of national debt. Over many years, deficits build up into large debts, and interest payments consume more and more of our taxes. The time has come when we must deal with this long run heritage of Keynes, the man with the short run solutions. Keynes, in his times, tossed it off with a quip: "In the long run we are all dead." His critics today observe, "In the long run we are all in debt."

6. Deficits and inflation.

- a. Deficits need not be inflationary, if the government

just borrows money that already exists. Inflation comes from (b), below.

- b. Borrowing from banks. For many years, especially after 1941 (Pearl Harbor), government borrowed from banks, and banks loaned bank deposits which they newly created for the purpose. In this short course we lack time to explain this process; you'll have to take it on faith for now. The effect is the same as though the banks printed new money to buy government bonds.

- c. As a result of \$b, deficits and inflation became coupled in the public mind.

- d. The uncoupling. Beginning around 1981, deficits soared but inflation did not. The U.S. Treasury was borrowing existing money, raising interest rates very high to do it. This policy is identified with William Voelcker, who preceded Alan Greenspan at The Fed.

There was concern that this would compete with private borrowers and "crowd out" private investing (W. J. Clinton played effectively to this concern in the 1992 campaign). In the short run the problem was solved by borrowing from abroad, especially Japan.

7. Final outcome of Keynes.

a. Keynes' concerns with aggregate supply and demand became known as Macroeconomics (the big picture). It has swelled up to become half of the discipline, e.g., Econ. 2. Neoclassical Economics survives as Microeconomics, e.g., Econ. 3. As in Marshall's supply and demand analysis, Micro deals with "partial" equilibrium. It has been summarized as the study of the "allocation of limited resources among competing ends." The emphasis is on trade-offs.

b. As applied policy, Macro became "demand management."

Critics called it bad names like "socialism," but most people didn't care, so long as it worked. Actually, it left most micro decisions to the market, while the Treasury, in synch with the central bank (The Fed) managed, or at least nudged, aggregate demand. Demand managers saw themselves not as challenging capitalism, but saving it.

c. Macro theory has become too compartmentalized. Micro

and Macro should be integrated, not treated in isolation. However, the march of overspecialization has raised and strengthened the wall between them. Integration is a major task for the future.¹

d. Politically, Keynes has been associated with the Democrats (although Nixon endorsed Keynes). When Reagan came in with "supply-side economics," Keynes as a name went out. However, the practice of deficit finance grew stronger. Reaganite economists rationalized it under a new name: "the

Ricardian Equivalence Theorem." We lack time to explain the new rationale. It is deficit finance in new wrapping.

e. Now, balancing the budget has become a universal slogan on both sides of the aisle in Congress. The unanimity is more apparent than real, however. For one major Party, budgetbalancing is code for cutting spending; for the other, it is code for raising taxes. Guess which Party is which.

¹ For advanced readings on the point, ask the instructor.

J. M. KEYNES - Questions

1. Explain the difference between Keynes' and Marshall's use of the terms "supply and demand."
2. Contrast the secular "Laws of Motion" advanced by Malthus and Keynes.
3.
 - a. What is "Say's Law?"
 - b. How did Keynes try to refute it?
 - c. How did Say's supporters say the rate of interest would make the law hold?
 - d. How and why did Keynes try to refute their arguments?
4. Compare Keynes and Marx, as to: a) under-consumptionism; b) the tendency of the MROR on capital to fall towards zero; c) the role of elites in leading society.

Extra credit: Contrast those views with those of the American Populist/Progressives, George and Veblen.

5. Keynes overtly ignored questions of factoral distribution such as Mill stressed, yet they crept in in two covert (hidden) ways. What are these?
6. Keynes jarred economics when he introduced a concept of "positive feedback" into the system. When it was bad, it was a "vicious downward spiral," when good, "the multiplier." Explain his reasoning.
7. Ricardo, Mill, Marx, and Keynes all forecast that capital would become superabundant, leading to interest rates' approaching zero. Hobson and Lenin saw this glut of capital leading to imperialism. Yet today there is fear of under-saving and a capital shortage in the U.S. Where did those forecasts go wrong? (Note: this involves Keynes.)
8.
 - a. Which Worldly Philosophers saw the subject mainly as the dismal science of making hard choices?
 - b. Which ones saw ways to achieve two or more good results together, mutually reinforcing? Explain.

J. M. KEYNES - Answers

1. Marshall's supply and demand referred to one commodity, such as cotton, at a time, and in one place or market at a time. "One commodity" might be aggregated into one group of related commodities, e.g. clothing or shelter, but hardly more than that. Keynes' supply and demand were aggregates for the whole economy: demand for all goods, supply of all goods.

2. Malthus foresaw population growing too fast and pressing on a limited supply of land, leading to grimmest poverty for most people not owning land. He saw no solutions except birth control through abstinence, and, failing that, high deathrates caused by hunger, disease, warfare, etc. Keynes saw production growing faster than goods were consumed, leading to a general glut of goods, throwing people out of work, and forcing the MROR on new investing down to zero.² Keynes saw a solution in having government first add to demand by spending, and then manage aggregate demand to keep it high enough to employ all those wanting to work, and encourage private investing by adding to consumer demand.

3. a. According to Say's Law, there can be no general glut of

goods produced, because "supply creates its own demand."

b. Keynes tried to refute Say by saying that suppliers may

save part of their incomes, and fail to spend the savings on investing. In simplest terms, people may just hoard money. In somewhat more advanced terms, the rate of circulation of money

² Malthus foresaw the same problem. This seems totally inconsistent with his main concern, except if we see him as an incorrigible worry-wart and pessimist.

may slow down.

c. Say's supporters said that oversaving would "make money cheaper" (i.e., lower the rate of interest). The interest rate is simply the price that brings equilibrium between the supply of funds (savings) and the demand (investing). Lower interest rates will damp savings and spur investing, until they are equal - just as any price does.

d. Keynes said that when the MROR on capital falls below

about 2%, lower interest rates fail to work their negative feedback. Savers will save anyway, and just hold cash, motivated by what Keynes called "liquidity preference." They require at least 2% return from borrowers just to offset what he called "lenders' risk," i.e. the risk of non-repayment. Thus, when the MROR falls to 2% or below, money stops circulating. He called this the "liquidity trap," and said it could be infinite. Seems pretty far out now, but for a long time people bought it.

4. a. Both Keynes' and Marx's pessimism was based on

underconsumptionism, but each went further. Keynes proposed curing the problem by subsidizing investing in several ways (see Keynes, #5). Marx said the organic composition of capital would rise (more fixed capital, less circulating capital), this would lower what he called the "rate of profit" (meaning roughly the MROR) and capital would go on strike, in effect. Marx's reasons why it would lower the MROR are a bit tortured, which is too bad, because up this point he seems to have been on the track of a plausible theory.³ As to cures, Marx had no interest in any cure that would delay the death of capitalism, and the "inevitable" revolution.

b. Both Keynes and Marx forecast a fall of the MROR towards or to zero. Keynes' name for the MROR was the "Marginal Efficiency of Capital," a term that was standard and "politically correct" for many years, even though it has little to do with "efficiency," in the usual definition.⁴ Keynes anticipated what he dramatically and memorably called "the euthanasia of the rentier." Before calling Dr. Kevorkian, note that this is a bit of a contradiction in Keynes, because land rents vary inversely with returns to

³ The Austrian economists worked this out better than Marx. Like Marx, they drew on Ricardo. If you are interested in pursuing this, ask me.

⁴ Another Keynesian term was "fructify." You can understand why that has dropped from common usage, but it's too bad because the term expresses what economics seeks to achieve: to "make fruitful," or put to use.

capital, so a fall in the MROR raises land rents, which are part of the Average ROR.⁵

We resolve the contradiction as follows. Recall that he favored upholding the MROR by subsidy, if needed. Thus, the euthanasia, if any, would fall on those rentiers living on land rents: rentiers in the root sense of the word. It is quite possible that Keynes was being deliberately vague or ambiguous on the point: he was good at that.

Marx's forecast was based on a rising organic composition of capital, meaning more capital ("dead labor") was combined with less and less living labor. Through tortured reasoning he then said profits only come from living labor, so profits would fall.

(Both writers expressed themselves through references to death. This may be only a coincidence, but is a striking one. [Oh, Dr. Freud! Calling Dr. Freud!])

c. Keynes took it for granted that sparkling élite intellectuals like himself should lead society, and made little effort to communicate outside a small circle. Marx took it for granted that another kind of élite would take over: a small cadré of self-educated professional revolutionaries, working through labor unions.

Extra credit answer. George was an American folk-hero and political leader who believed in and practiced democracy, the more direct, the better. He and his followers accomplished many electoral reforms. In Britain, they gelded the House of Lords in 1911; in the U.S.A., see Henry George #1, para. 2. Thorstein Veblen put his faith in the engineering profession. He thought that working with machinery made people more rational, and ultimately more powerful, so engineers would wrest power over business and lead us into an economy of unbridled production and abundance.

5. a. Keynes thought a major cause of underconsumption was low

wages. He favored distributing a higher share of income in

wages, a lower share to providers of capital.

b. Keynes favored upholding the MROR on investing, but not

the Average ROR, which includes land rents. Thus, he would help people who invested by hiring labor to produced goods. As for

⁵ It also raises the Price/Rent ratio, thus doubly raising land prices.

the others, he forecast their ``euthanasia," and it may be he thought it would be a good thing.

6. See Keynes #5.

7. There is no pat answer to this one: you're on your own. This should make for a penetrating and lively discussion by the class.

8. a. Dismal economists offering only hard choices include Malthus, Clark, Edgeworth, Ely, and perhaps Marshall.

b. Keynes wrote that raising wage rates, and raising consumer spending, would actually raise capital formation, by raising incomes. Thus we can ``have it all." As to George, see Henry George, #2. Laffer said we can lower tax rates and raise more revenue.