

# MBHS Economics Club

## Economic History Pt. 2 Notes

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## Classical Economics

Created by Adam Smith (see notes from last week), existed as the dominant theory up until the late 19th century

Some core ideas:

- Mostly agreed with the labour theory of value
- Advocated for *laissez-faire* capitalism and greater free trade

Some controversies:

- Many accepted Say's law and denied the possibility of a general glut ( see glut notes)
- Others(Malthus, Birmingham school) proposed that underconsumption could bring about economic hardship and that government should act to mitigate this. These ideas were a minority at this time.

## Karl Marx (1818 – 1883)

- First non-mercantilist critic of capitalism
- Came to his ideas after seeing the horrific conditions experienced by the working class
- Analyzed society throughout history as a series of systems
  - Argued that human history was the history of class struggle
- Criticized capitalism for its instability; called for a revolution of the working class
- Wrote two revolutionary books:
  - *The Communist Manifesto* (1848)
  - *Das Kapital* (1867-1883)

## Marxian commodity theory:

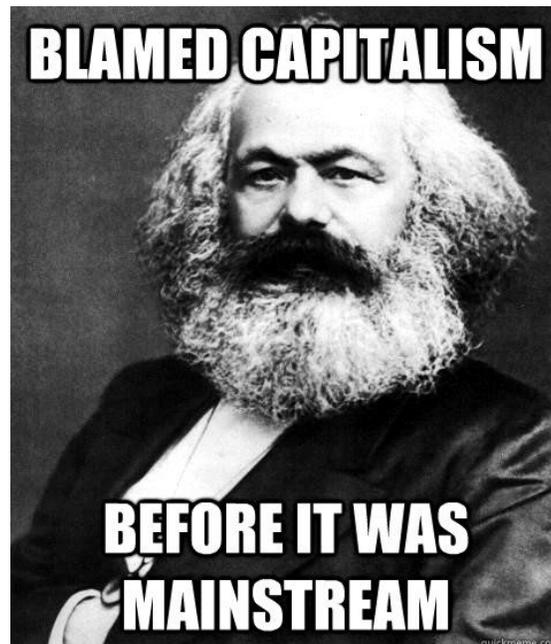
- Tenets:
  - All wealth in capitalist systems is based in commodities.
  - Commodities are the result of a natural good combined with labor.
  - Commodities have two values: use and exchange.
  - Use value is what we would now call utility.
  - Real value is correlated with societally required labor.
- This was not particularly controversial, but what he derived from it was:
  - Exchange value can be influenced by power relations.
  - Workers are also just commodities, produced by the combination of labor and humans, where the societally required labor is just what is needed to keep a man alive and working.
  - Employers generated profit by giving less to workers in exchange value than what they were worth in use value, exploiting them.

## The Cycle of Joy

Marx criticised capitalism for its instability. According to Marx, capitalism lead to the abuse of the working class. He described the cycle as thus:

1. Competition drives employers to reduce costs, they employ labour saving devices, which reduces the number of jobs
2. Drives up profits, but also increases unemployment

3. This continues, more and more are unemployed, and a drop in wages results as competition grows
4. Eventually, a general glut of unsold goods accumulates because of the falling buying power of the poor
5. Despite cost cutting, profits fall and a depression begins
6. The glut is eventually cleared, and the economy returns to normal growth
7. Repeat for endless joy



*Fig 1.0: Meme Marx*

### **Marx's Conclusions**

Marx concluded that with every capitalist cycle:

- Wealth polarisation would become more and more dramatic
- Eventually, the working class will form a class consciousness
- Class tensions would reach a breaking point, a revolution will occur, and the world will be restructured into a collective system
- However, Marx did not say how this system should be structured

### **Alfred Marshall**

Boiled some economic ideas and math to make Neoclassical Economics

- Added scientific rigour to economics
- Shifted focus from the market economy to human behavior
- Introduced a lot of new ideas to economics

## Economies of Scale

- As an operation or business gets larger it, it sees increased per unit profitability
  - Mathematically speaking, getting larger reduces long run average costs (LRAC) of production by shifting the short-run average total cost (SRATC) curve down and to the right.
  - This occurs via:
    - Fixed costs being spread out over more units of output
    - Lower costs when purchasing in bulk
    - Higher Operational Efficiency
  - But there are numerous restrictions on this increase in profitability
    - Exceeding the nearby raw material supply
    - Saturating regional markets
    - Higher defect rates
- Economies of scale was created to explain the real world phenomenons
  - International Trade
  - Number of firms in a market

## Surplus

Marshall pioneered ideas about this, and it is sometimes referred to Marshallian Surplus (which is theoretically equivalent to Marx's Labour concept of value).

There are two main types of surplus:

- Consumer Surplus
  - This is the monetary gain obtained by consumers by paying less for goods than the maximum price they are willing to pay for
- Producer Surplus
  - The monetary gain obtained by producers by selling for more than the minimum price they are willing to sell for
  - This is almost equivalent to profit, because people will sell anything which is even marginally profitable, so the minimum price which they are willing to sell for is about the point of making 0 profit.

## Price Elasticity of Demand

**Elasticity** is the responsiveness of an economic variable to a change in another variable

- PED( $E_d$ ) The percent change in quantity demanded in response to a one percent change in price
- Approximated using this:

$$e_{(p)} = \frac{dQ/Q}{dP/P}$$

- This is not always completely accurate, but this is the best we can do without using significant calculus
- PED is usually negative, representing that an increase in price usually decreases demand. The notable exception to this is the class of Veblen Goods.

## Thorstein Veblen

- One of the most prominent non communist critics of capitalism.
- He published an influential book, *The Theory of Leisure Class* in 1924
  - The theory of Conspicuous Consumption:
    - Veblen Goods - Goods whose demand is directly proportional to its high price. Such goods exist because rich people like showing off how rich they are, and hence buy really expensive things. (This happens all around us right now... just think about it)
  - Idea of Conspicuous leisure
    - Visibly being lazy for the purpose of displaying social status, and as detrimental as, if not more detrimental than, conspicuous consumption of Veblen Goods.



*Fig 2.0: Veblen Goods at their finest.*

- Ideas of Business, Enterprise, and Industry
  - An analysis of conflicting yet intertwined motivations
  - Enterprise - Curtail production to get more ca\$hmoney
  - Industry is essentially "MAKE ALL THE THINGS"
- From these ideas he thought, like Marx, that capitalism would transition into socialism. Unlike Marx however, he saw this change as being peaceful and natural, a result of socialism being more inline with democratic principles. In fact, he went as far as saying that the application of market forces, taking into account the government as an actor which worked with the will of the people, would cause socialism.

- All these ideas ended up creating the basis of institutionalist economics, the study of economics as an evolutionary system based around certain principles. It is from this branch of that that we derive market cycles to day, and, as a result, see the importance of Veblen's works today.

### **Good Ole Keynes**

We talked about Keynes in some of our earlier meetings. We'll talk about him some more in the next meeting. And some of the criticisms of Keynes. h/t to Ayn Rand (not an economist, just a fascist... sorry Komo.)