
History of Economic Thought

Mr Traynor©

Economics
Pack 10



Short Questions

1)

Outline **four** contributions of Adam Smith to economic thought.

(i) _____

(ii) _____

(iii) _____

(iv) _____

(17 marks)

2)

Outline **THREE** key ideas, which John Maynard Keynes contributed to economic thought.

(i) _____

(ii) _____

(iii) _____

(17 marks)

3)

Name the economist primarily associated with the following economic concepts:

(i) **Iron Law of Wages :** _____

(ii) **Law of Comparative Advantage:** _____

(iii) **Laissez Faire :** _____

(iv) **Liquidity Preference Theory:** _____

(16 marks)

4)

Outline **THREE** key ideas which John Maynard Keynes contributed to economic thought.

(i) _____

(ii) _____

(iii) _____

(16 marks)

Long Questions**2013**

Explain briefly Karl Marx's economic theory about the exploitation of labour in a capitalist system.

(10)

2012

The classical economist, Thomas Malthus, in his work *An Essay on the Principle of Population* (1798) created a theory on population.

- (i) Explain Malthus's theory on population.
- (ii) Is Malthus's theory on population relevant today? Explain your answer. (20)

The economist John Maynard Keynes, author of *The General Theory of Employment, Interest and Money* (1936), supported the use of fiscal policy by Government to create full employment.

- (i) Explain the above statement.
- (ii) Discuss **two** other key concepts which Keynes contributed to economic thought. (25)

2010

The economist Milton Friedman was regarded as one of the major thinkers of the monetarist school of economic thought.

Outline **four** features of 'Monetarism'.

(20 marks)

2009

Write a brief note on David Ricardo's contributions to economic thought.

(15 marks)

2007

In the case of any **TWO** of the following economists, outline **TWO** contributions which **each** one has made to the development of economic ideas:

Adam Smith; Alfred Marshall; John Maynard Keynes; Milton Friedman.

(20 marks)

2003

Adam Smith, author of ‘The Wealth of Nations’ (1776), explained the reasons for and benefits of free trade.

Outline **FOUR** other areas in which he made contributions to economic thought.

(20 marks)

Short Questions Answers

1)

Outline **four** contributions of Adam Smith to economic thought.

(17 marks)

- (a) **The pursuit of self-interest**
This best benefits the individual and hence best benefits society.
- (b) **The Division of Labour**
Increased productivity and increased country’s wealth.
- (c) **Labour Theory of Value**
The value of a product was equal to the amount of labour that went into producing the product.
- (d) **State protection of property rights**
Encourages the accumulation of personal wealth.
- (e) **'Invisible hand of competition'**
Allows a self-regulating market to operate thus ensuring economic progress is achieved.
- (f) **Perfect Competition**
Free entry into markets; profits sufficient to reward entrepreneurs; inefficiency penalised and price based on the cost of production. Monopolies would not persist.
- (g) **Laissez-faire / Limited government intervention**
Except for defence/justice.
- (h) **Canons of Taxation**
To fund the state’s defence/justice systems taxation was necessary and he developed the four principles of a fair tax system: equity, economy, certainty and convenience.
- (i) **Paradox of Value** He distinguished between ‘value in use’ and ‘value in exchange’. Some items had an immense utility (i.e. air, water) but are not exchanged, while others (i.e. diamonds) possessed little utility but could command a great value in exchange.
- (j) **Advocated Free Trade**
He advocated international free trade unhindered by the imposition of tariffs so that markets could operate effectively and allow the gains from trade to be spread between nations.

5+4+4+4

2)

Outline THREE key ideas, which John Maynard Keynes contributed to economic thought.

- (a) National income could reach equilibrium without reaching full employment.
- (b) The level of national output is demand determined.
- (c) He favoured government intervention in the economy.
The job of the government is to manage the economy.
The government can use fiscal policy to create full employment.
(The size of national income depends on expenditure and hence employment depends on expenditure).
- (d) He stated that investment by entrepreneurs depended more on businessmen's expectations than on the rate of interest.
- (e) Investment could be less than savings and cause a leakage in spending which decreases national income and employment.
- (f) He created new economic tools to explain his theories- the multiplier, MPC, MPM, etc.
- (g) The multiplier: any initial increase in spending will cause a greater increase in GNP.
- (h) The liquidity preference theory: people desired to hold their wealth in money form for three reasons: transactionary, speculative and precautionary.
- (i) He favoured a managed system of foreign exchange rates rather than the gold standard.

17 marks graded

3)

Name the economist PRIMARILY associated with the following ideas: 16 marks graded

	<i>Idea</i>	<i>Economist</i>
(i)	Iron Law of Wages	Robert Thomas Malthus
(ii)	Law of Comparative Advantage	David Ricardo
(iii)	Laissez Faire	Adam Smith
(iv)	Liquidity Preference Theory	John Maynard Keynes

4)

THREE key ideas, which J.M.Keynes contributed to economic thought.

- (a) National income could reach equilibrium without reaching full employment.
- (b) The level of national output is demand determined.
- (c) He favoured government intervention in the economy.
The government can use fiscal policy to create full employment.
- (d) He did not accept the view of classical economists that a flexible rate of interest ensured that all savings were invested.
- (e) He stated that investment by entrepreneurs depended more on businessmen's expectations than on the rate of interest.
- (f) Investment could be less than savings and cause a leakage in spending which decreases national income and employment.
- (g) He utilised economic tools to explain his theories- the Multiplier, MPC, MPM etc.
- (h) He developed a liquidity preference theory / Savings theory.
- (i) He favoured a managed system of foreign exchange rates rather than the gold standard.

3 key ideas: 6 marks + 5 marks + 5 marks each

Long Questions Answers**2013**

Explain briefly Karl Marx's economic theory about the exploitation of labour in a capitalist system.(10)

- Marx argued that workers were paid subsistence / minimum wages by their employers.
- The value of the goods produced by a worker was more than the wages paid to the worker. (The difference between the two he called the '**surplus value**' or **profit** to the employer). This illustrated that workers were exploited and in time would be replaced by capital resulting in their unemployment.

10 marks (6+4)

2012

- (c) The classical economist, Thomas Malthus, in his work *An Essay on the Principle of Population* (1798) created a theory on population.
- (i) Explain Malthus's theory on population.
- (ii) Is Malthus's theory on population relevant today? Explain your answer. (20)

- (i) Explain Malthus's theory on population.
- Malthus stated that population increases in a geometric progression (i.e. 2, 4, 8, 16 etc) while food supply increases in an arithmetic progression (i.e. 2, 3, 4, 5 etc).
 - Population would outgrow the means of subsistence. The outcome would be famine, disease etc.

10 (4+4+2) marks.

- (ii) Is Malthus's theory on population relevant today? Explain your answer.

	Yes His theory is relevant today	No His theory is not relevant today
Population	<ul style="list-style-type: none"> • The rapid increase in population • World population has exceeded 7 bn • There is an uneven distribution of population worldwide between LDCs and DCs. 	<ul style="list-style-type: none"> • Extensive population control measures are in place worldwide which are helping control population growth. • Some countries impose strict population controls e.g. China's 'One Child Policy'.
Food Production	<ul style="list-style-type: none"> • The rapid increase in population cannot be matched with a proportionate increase in food production. • In some developing countries there is malnutrition. • The UN estimates that in Africa if population and soil degradation continues, the continent might be able to feed just 25% of its population by 2025. 	<ul style="list-style-type: none"> • Because of the development of high yielding crops /Genetic modification means that food production is being increased. • The availability of cheaper imports from developed nations (EU; North America) is helping the distribution of food worldwide.
	2 points at 5 marks each.	2 points at 5 marks each.

(c) The economist John Maynard Keynes, author of *The General Theory of Employment, Interest and Money* (1936), supported the use of fiscal policy by Government to create full employment.

(i) Explain the above statement.

(ii) Discuss **two** other key concepts which Keynes contributed to economic thought. (25)

(i) Explain the above statement.

- He suggested government cut direct taxation to boost income, therefore boosting expenditure to help create jobs.
- The government could increase its expenditure, thereby increasing demand (through direct public works) so as to help create jobs.

13 (9+4) marks.

(ii) Discuss **two** other key concepts which Keynes contributed to economic thought

Equilibrium National Income.

National income could reach equilibrium without reaching full employment.

Output is demand determined.

The size of national income depends on expenditure i.e. $Y = C + I + G + X - M$

Investment decisions by entrepreneurs.

He stated that investment by entrepreneurs depended more on businessmen's expectations than on the rate of interest.

Investment could be less than savings.

This could result in a leakage in spending which decreases national income and employment.

New Economic Concepts – The Multiplier

He developed new tools to explain his theories including the multiplier: Any initial increase in spending will cause a much greater increase in GNP due to the fact that one person's expenditure is another person's income. He developed concepts such as: MPC, MPM, etc.

Liquidity Preference Theory:

People may prefer to hold their wealth in money form for three reasons: transactionary; precautionary and speculative reasons.

Managed system of exchange rates:

He favoured a system of foreign exchange rates which could be 'managed' by the state rather than the gold standard.

2 at 6 marks each.

2010

The economist Milton Friedman was regarded as one of the major thinkers of the monetarist school of economic thought. Outline **four** features of 'Monetarism'. (20 marks)

Monetary policy should be the main instrument used by the government to manage the economy and not fiscal policy. Increased government expenditure would only lead to higher prices and not increased output and employment as advocated by Keynes.

Control of money supply

Monetarists suggest strict control of the money supply so as to control inflation. Limiting credit availability, keeping interest rates high would control consumer borrowing.

Reduction in inflation increases competitiveness which may lead to relatively cheaper exports, increased exports and job creation in the long run. Companies should keep wage increases to a minimum in order to avoid cost-push inflation.

Laissez faire principles

Monetarists favour a return to laissez faire principles: minimum state intervention; de-regulation of markets; privatisation of state bodies.

Supply side policies

Monetarists favoured any policies which improve market efficiency / boost supply/ reduce the ability of trade unions to interfere with the labour market.

4 at 5 marks each.

State: 2 marks. Explain: 3 marks.

2009

Write a brief note on David Ricardo's contribution to economic thought.

Law of Comparative Costs

Ricardo supported the idea of free trade and developed the law of comparative costs which states that a country should specialise in the production of those commodities in which it is relatively most efficient and trade for the remainder of its requirements.

Theory of Economic Rent

If population increased it was necessary to use inferior / more remote land. For use of this land rent was paid. As a result the price of food rose. Cost of producing on the best land was lower therefore food produced on this land earned a surplus over that produced on inferior land. This surplus led to an increase in rent payable for the use of good land.

Accepted the Subsistence Wages Theory

He believed that any increase in wages above the subsistence level would cause an increase in population which would in turn cause wage levels to fall.

15 marks graded

2007

- (c) In the case of any **TWO** of the following economists, outline **TWO** contributions which each one has made to the development of economic ideas: Adam Smith, Alfred Marshall, Keynes, Milton Friedman (20 marks)

Adam Smith

- (a) **The pursuit of self interest** –
This best benefited the individual and hence best benefited society.
- (b) **Division of Labour** –
Increased productivity and a country's wealth. His example - the manufacture of pins illustrated the benefits of the division of labour.
- (c) **Labour Theory of Value** –
The value of an item was equal to the amount of labour that went into producing the product.
- (d) **State protection of property rights** –
Encourages the accumulation of personal wealth.
- (e) **'Invisible hand of competition'** –
Allows a self regulating market to operate thus ensuring economic progress is achieved.
- (f) **Perfect Competition** -
Free entry into markets; profits sufficient to reward entrepreneurs; inefficiency penalised and price would be based on the cost of production. Monopolies would not persist.
- (g) **Laissez-faire** –
no justification for government intervention in the economy except for defence/justice.
- (h) **Canons of Taxation** –
To fund the state's defence/justice systems taxation was necessary and he devised the four principles of a fair tax system: equity, economy, certainty and convenience.
- (i) **Paradox of Value** –
He distinguished between 'value in use' and 'value in exchange'. Some items had a vast utility (air, water) but are not exchanged, while others (diamonds) possessed little utility but could command a great value in exchange.
- (j) **Free Trade** –
He advocated international free trade unhindered by the imposition of tariffs so that markets could operate effectively and allow the gains from trade to be spread between nations.

Alfred Marshall

- (a) **Theory of Value**
The value of a commodity was determined in the short-run by its utility and demand and in the long-run was determined by its cost of production.
- (b) **Distribution of income / wealth:**
The return to each of the factors of production was determined by their marginal productivity.
- (c) **Competition regulated economic activity:**
Government intervention and inter-business co-operation could regulate economic activity and enhance economic freedom.
- (d) **Growth of monopolies could be prevented by:**
Regulation by government; consumer information; increased number of small investors/more accountability.
- (e) **Quasi rent:**
The economic rent earned by factors of production in the short run when demand exceeded supply.
- (f) **Developed concepts of price-elasticity of demand / consumer surplus / how markets adjusted to changes in D & S over time:** quantifying buyers' sensitivity to price; the surplus value or utility a consumer enjoys; Market period, short period and long period.

John Maynard Keynes

- (a) **National Income at less than full employment:**
Keynes observed that national income could reach equilibrium without reaching full employment and hence he suggested government intervention to help create jobs when required.
- (b) **Output is demand determined.**
The size of national income depends on expenditure i.e. $C = I + G + X - M$
- (c) **Favoured government intervention in the economy.**
The job of the government is to manage the economy.
The government can use fiscal policy to create full employment.
- (d) **Investment decisions by entrepreneurs.**
He stated that investment by entrepreneurs depended more on businessmen's expectations than on the rate of interest.
- (e) **Investment could be less than savings.**
This could result in a leakage in spending which decreases national income and employment.
- (f) **New Economic Concepts – The Multiplier**
He developed new tools to explain his theories including the multiplier: Any initial increase in spending will cause a greater much greater increase in GNP due to the fact that one person's expenditure is another person's income. He developed concepts such as: - MPC, MPM, etc.
- (g) **Liquidity Preference Theory:**
People may prefer to hold their wealth in money form for three reasons:
transactionary; precautionary and speculative reasons.
- (h) **Managed system of exchange rates:**
He favoured a system of foreign exchange rates which could be 'managed' by the state rather than the gold standard.

Milton Friedman

- (a) **Monetary policy:**
Should be the main instrument used by the government to manage the economy.
- (b) **Control of money supply:**
Monetarists suggest strict control of the money supply so as to control inflation.
- (c) **Reduce inflation:**
This increases competitiveness which may lead to increased exports and job creation in the long run..
- (d) **Laissez faire principles:**
He favoured a return to laissez faire principles - with minimum state intervention; de-regulation of markets; privatisation of state bodies.
- (e) **Supply side policies:**
He favoured any policies which improved market efficiency / boosted supply: de-regulation of markets; reducing the ability of trade unions to interfere with the labour market.

2 economists at 10 marks each graded.

2003

- (c) Adam Smith, author of 'The Wealth of Nations' (1776) explained the reasons for and benefits of free trade. Outline FOUR other areas in which he made contributions to economic thought.

(20 marks)

(i) The pursuit of self-interest

'What best benefited the individual, best benefited the society'.

(ii) Division of Labour

Increased productivity leading to increased wealth in a country. He illustrated his theory with the example of the manufacture of pins.

(iii) The Labour Theory of Value

The value of an item was equal to the amount of labour that went into producing the product.

(iv) 'Invisible hand of competition'

He advocated the operation of a self regulating market, thus ensuring that economic progress was achieved.

(v) Perfect Competition

Adam Smith favoured perfectly competitive markets. This allowed free entry into the market, profits sufficient to reward entrepreneurs, inefficiency penalized and prices based on the cost of production. Monopolies would not persist.

(vi) Laissez-faire

He believed that there was no justification for government intervention in the economy, except for national security such as defence / justice.

(vii) Canons of Taxation

To fund the state's defence/justice systems taxation was necessary and he devised the four principles of a fair tax system: equity, economy, certainty and convenience.

(viii) Paradox of Value

He distinguished between 'value in use' and 'value in exchange'. Some items have a vast utility (air, water) but are not exchanged, while others (diamonds) possess little utility but can command a great value in exchange.

(ix) Protection of property rights

By protecting personal property rights an individual could accumulate wealth. The individual benefited and thus so did society.

20 marks: 4 x 5 marks each graded