

**CHAPTER 6. DEPENDENCE OF THE DIVISION OF LABOR ON CAPITALISM II:
THE PRICE SYSTEM AND ECONOMIC COORDINATION
PART A. UNIFORMITY PRINCIPLES**

_____ 1. The uniformity-of-profit principle states that there is a tendency toward an equalization of profit margins throughout the economic system.

_____ 2. The uniformity-of-profit principle states that there is a tendency toward the equalization of the rate of profit (rate of return) on capital invested throughout the economic system.

_____ 3. The achievement, throughout the economic system, of a uniform rate of profit on capital invested is consistent with the existence of permanently unequal profit margins counterbalanced by permanently unequal capital turnover ratios.

_____ 4. Assume that supermarkets have profit margins of 2 percent, automobile companies 10 percent, and electric utilities 20 percent. If the ratio of sales revenues to capital invested (i.e., capital turnover ratio) is 5:1 for supermarkets, 1:1 for auto companies, and 1:2 for electric utilities, calculate the respective rates of profit on capital invested for

- a. supermarkets
- b. automobile companies
- c. electric utilities

_____ 5. The existence of unequal rates of profit in the various branches of production

- a. creates incentives for the investment of additional capital in the industries earning above-average rates of profit and for the withdrawal of capital from industries earning below-average rates of profit
- b. the effect of the investment of additional capital in the industries earning above-average rates of profit is to increase the supply of products they produce and thus to reduce the selling prices, profit margins and rates of profit of those industries
- c. the effect of the withdrawal of capital from the industries earning below-average rates of profit is to reduce the supply of products they produce and thus to raise the selling prices, profit margins, and rates of profit of those industries
- d. all of the above

_____ 6. An above-average rate of profit provides not only the incentive for the investment of additional capital in the industries concerned but also the means for increased capital investment insofar as the above-average profits are themselves saved and reinvested.

_____ 7. Losses provide not only the incentive for the withdrawal of capital from the industries concerned but also themselves directly reduce the capital invested in the industries that suffer them.

_____ 8. Low positive rates of profit that are insufficient to cover dividends being paid also directly result in the reduction of the capital invested in an industry.

_____ 9. The uniformity-of-profit principle serves to make mistakes of relative overinvestment and overproduction and relative underinvestment and underproduction self-correcting.

_____ 10. The uniformity-of-profit principle counteracts the mistakes of relative overinvestment and overproduction and relative underinvestment and underproduction, and thus promotes coordination in the relative size of the various branches of production because

- a. mistakes of the first kind result in low profits or losses, which serve to halt and reverse the relative overinvestment and overproduction
- b. mistakes of the second kind result in high profits, which provide the incentive and means for stepped up investment and production
- c. both (a) and (b)

_____ 11. The uniformity-of-profit principle delimits the size of the mistakes of relative overinvestment and overproduction and relative underinvestment and underproduction, by making the counteracting forces of correction through respectively falling and rising rates of profit more powerful as the size of the mistake increases, with the result that "the bigger the mistake, the harder it is to make it."

_____ 12. The uniformity-of-profit principle serves to largely prevent the mistakes of relative overinvestment and overproduction and relative underinvestment and underproduction from being made in the first place

- a. because the desire of investors to make profits and avoid losses and to make higher profits in preference to lower profits makes them strive to avoid investments representing overinvestment and overproduction and to seize the profit opportunities created by others' insufficient investment
- b. at any given time, most of the capital of the economic system tends to be in the hands of investors with prior investment success, in that large capitals will tend to be in the hands of those who have succeeded in making high profits, which they have largely saved and reinvested, and the earning of which signifies investing in lines where investment was greatly needed, while those who invested where investment was not needed have incurred losses and thus now command correspondingly less capital
- c. both (a) and (b)

_____ 13. The uniformity-of-profit principle gives consumers the power to change the pattern of production, i.e., to cause industries to expand or contract,

merely by changing their pattern of buying and abstention from buying.

- _____ 14. Products continue to be produced because
- businessmen go on producing them
 - consumers value the products and are prepared to pay profitable prices for them

_____ 15. Insofar as goods are produced in a free market to which various people object—such as allegedly nonnutritious breakfast cereals, automobiles without seatbelts or airbags, trashy or pornographic literature, alcoholic beverages, cigarettes, and so on—the logical targets of the complaints are the consumers, even though the actual targets are almost always the manufacturers.

_____ 16. The uniformity-of-profit principle operates to bring about a progressive increase in production because in order to earn an above-average rate of profit in the face of its operation, it is necessary to introduce repeated improvements in products and methods of production.

_____ 17. Improvements in products and methods of production are the source of high profits only until competitors can copy them to the point of making them the general standard of the industry, at which point the continued earning of high profits requires the introduction of further improvements.

_____ 18. No matter what its record of past success in innovation, a company is doomed if competitors not only catch up to it but now more and more pull ahead of it.

_____ 19. In the face of innovative competitors, adopting improvements is necessary not only to earn premium profits but also to staying in business at all, in that while premium profits go to the innovators, no profit whatever goes to those who lag too far behind the innovators.

- _____ 20. The uniformity-of-profit principle implies
- increasing production and falling prices
 - where virtually costless, irredeemable paper is the monetary unit, an increase in the quantity and fall in the value of such money more rapid than the increase in the production and supply of goods and thus rising prices expressed in terms of such money
 - both (a) and (b)

_____ 21. The empirical fact that the great majority of prices have risen over the last seventy years is a contradiction of the proposition that the uniformity-of-profit principle operates to reduce prices.

The following is a two-part question, based on the assumption that a new light bulb sells for \$1 and costs 90¢ to produce and that a ten-times longer-lasting light bulb could be produced at the same unit cost.

_____ 22. Give an estimate of how much more consumers would be willing to pay for the ten-times-longer lasting bulb.

_____ 23. Give an estimate of how much more the light-bulb manufacturer would have to charge to make more profit on one ten-times longer-lasting bulb than on ten of the present bulbs, allowing five cents of lost recovery of depreciation on each of the present bulbs.

- _____ 24. Claims that businesses engage in “planned obsolescence”
- imply that, contrary to the uniformity-of-profit principle, the profit motive operates to make prices higher rather than lower
 - ignore the fact that to compensate for any lost unit volume due to greater durability of their products, business firms need to raise their prices by far less than the premium consumers are typically willing to pay for the greater durability
 - both (a) and (b)

- _____ 25. Cutting costs of production
- by means of the use of labor-saving machinery, or the use of less expensive materials or components that are less expensive because less labor is employed in their production, has the effect of making labor available for the production either of more of the product whose costs of production are cut or more of other products in the economic system
 - by means of the use of less expensive labor which is less skilled, or of materials that are less expensive because of their comparative abundance and/or lack of valuable alternative uses, is equivalent to increasing the supply of more valuable labor and materials and their products at the expense of reducing the supply of less valuable labor and materials and their products
 - both (a) and (b)

- _____ 26. Cost cuts
- are sought by businessmen in order to improve their profits
 - serve to expand production in the economic system
 - both (a) and (b)

_____ 27. Premium rates of profit can be earned by better anticipating changes in consumer demand than others, because doing so enables one to be early on the scene in cases in which increases in consumer demand serve to create a premium profit.

_____ 28. Economic progress results in such large-scale changes in the pattern of consumer demand as accompanied cost-cutting improvements in agriculture, which served to make food and fiber less expensive and thus to enable people to afford more of numerous other things.

_____ 29. Successfully anticipating changes in consumer demand operates to increase the gains from economic progress because it represents the movement of

capital and labor into the production of the things consumers wish to obtain as the fruits of the progress. For example, improvements in the efficiency of producing foodstuffs would have been of far less value if the capital and labor saved had been applied to the production simply of more foodstuffs rather than make possible the expansion of production outside of agriculture.

_____30. A minimum price control is a price control that imposes

- an artificially low price
- an artificially high price
- an artificially high price below which one is prohibited from selling

_____31. A maximum price control is a price control that

- imposes an artificially high price
- an artificially low price
- an artificially low price above which one is prohibited from selling

_____32. A synonym for maximum prices is ceiling prices.

_____33. A synonym for minimum prices is floor prices.

_____34. Farm subsidies, minimum wage laws, and labor-union wage scales imposed by government policy are all examples of minimum prices.

_____35. Rent controls and the price controls imposed on oil and other products in the 1970s are examples of maximum price controls.

_____36. If the government abolished its farm subsidy program and refunded its cost to the taxpayers, who pay for it, the effects would be

- a plunge in the sales revenues and profits of agriculture
- a rise in the sales revenues and profits of the additional things purchased by the tax payers
- a shift of capital and labor out of agriculture and into the things in additional demand by the taxpayers
- a restoration of the rate of profit in the smaller-sized agriculture that would remain
- the elimination of premium profits on the things bought by the taxpayers with their tax savings as the production of those things expanded
- all of the above

_____37. The permanent effect of the abolition of farm subsidies and the equivalent reduction of taxes would be the elimination of farm production that the market does not want sufficiently to be willing to pay profitable prices for it and the expansion of the production of other goods that the market does want sufficiently to be willing to pay profitable prices for them.

_____38. If long-standing rent controls were repealed,

- the immediate effect would be a sharp rise in rents and the profitability of rental housing

b. the longer-run effect would be an increase in the supply of rental housing and a reduction in rents toward the costs of providing such housing plus only as much profit as required to provide the going, competitive rate of profit

- the still longer-run effect would be a progressive fall in the real cost of rental housing and improvement in its quality as landlords once again came under the necessity of earning premium profits through making such improvements and competition progressively passed them on to tenants
- all of the above

_____39. The effect to be expected from repealing a maximum price control is a temporary surge in price followed by an increase in supply and decline in price, to the point where the industry no longer earns an exceptional rate of profit but is merely larger.

_____40. Experience following repeal of price controls on oil and oil products in the United States in 1980 contradicts the expectation expressed in the preceding question.

_____41. Since equity capital provides a buffer of security for the capital of lenders and thus reduces the risks of the lenders compared with those of the borrowers, the rate of profit on equity capital is generally likely to exceed the rate of interest paid on borrowed capital.

_____42. People are able to borrow money to the extent that they already have money because the wealth they have serves as a protective buffer for creditors. The greater their wealth, the greater the borrowings on which they can provide such a protective buffer.

_____43. The geographical uniformity-of-price principle states that there is a tendency toward the establishment of a uniform price for the same good throughout the world, plus or minus transportation charges.

_____44. The basis of the geographical uniformity-of-price principle is that the existence of an unequal price for the same good in two markets

- creates the opportunity for profit by buying in the cheaper market and selling in the dearer market
- the effect of such buying is to raise the price in the initially cheaper market while the effect of such selling is to lower the price in the initially dearer market
- the above process goes on until the price discrepancy is no greater than transportation cost
- all of the above

_____45. When the price of the same good in two markets differs by less than transportation cost, it does not pay to buy in the cheaper market in order to sell in the dearer market.

_____ 46. The ability of a government to create and maintain an inequality of price greater than transportation cost, as, for example, that created by a tariff, confirms the geographical uniformity-of-price principle rather than contradicts it, because the discrepancy can be maintained only if measures are taken of sufficient strength to offset the operation of the principle, such as severe penalties against smuggling combined with a great likelihood of being caught if one becomes a smuggler. If not for such penalties and the likelihood of suffering them, the tariff could not be effective.

_____ 47. The operation of the geographical uniformity-of-price principle serves to spread the effect of local failures of supply over a wider area, thereby reducing the severity of the local reduction in supply and correspondingly limiting the resulting rise in price.

_____ 48. In a free market, the effect of the Arab oil embargo of 1973 would have been

- a. a surge in the price of oil and oil products in the Northeastern United States, which was the region where the reduction in supplies mainly took place
- b. the movement of replacement supplies to the Northeast from elsewhere in the United States as soon as the price of oil and oil products in the Northeast exceeded the price in the rest of the country by more than costs of transportation
- c. the movement of replacement supplies to the United States as a whole from non-Arab foreign suppliers as soon as the price of oil and oil products in the United States came to exceed the price in those areas by more than the costs of transportation
- d. the resumption, despite the embargo, of the indirect import of Arab oil via third-parties, such as European refiners using Arab oil
- e. all of the above

_____ 49. In 1973 price controls on oil and oil products in the United States served to make illegal the action people would otherwise have been able to take to mitigate the effects of the Arab embargo.

_____ 50. In a free market, the effect of a foreign embargo against a country on the part of suppliers not controlling substantially all foreign supplies will be to reduce the supply of the embargoed good in that country

- a. by the amount no longer supplied by those conducting the embargo
- b. by nothing at all if those conducting the embargo go on selling the same overall amount but merely to different buyers
- c. by an amount commensurate only with whatever reduction the embargoing suppliers are able to achieve in the global supply of the good
- d. (b) and (c) but not (a)
- e. all of the above

_____ 51. The belief that if a country has lower tariffs than its trading partners it is at a disadvantage, is equivalent to the belief that if the winds and the ocean currents run toward it and cause its inbound transportation costs to be less than its outbound transportation costs, it is at a disadvantage.

_____ 52. The temporal uniformity-of-price principle

- a. is that in a free market, the expected price of a storable good in the future tends to exceed its price in the present by no more than the costs of storage for the period in question together with an allowance for the competitive rate of profit for the period in question
- b. exists because buying now for future sale when the present price is less than the expected future price by more than the factors indicated in answer (a) serves to raise the present price and the corresponding availability of more supply for the future serves to reduce the expected future price, thereby narrowing the difference in price
- c. by coordinating anticipated future demand and supply with present demand and supply, operates to balance the consumption of commodities over time and to minimize the effects of scarcities
- d. all of the above

_____ 53. In serving to raise current or spot prices in anticipation of higher prices in the future, commodity speculators bring about a curtailment of present consumption and an enlargement of supplies available for the future when they are more needed.

_____ 54. By encouraging an undiminished rate of consumption, a price control can turn a scarcity of a storable good into a famine.

_____ 55. Speculators as a class cannot profit from price increases caused by their own activity because if nothing else but their buying were present to raise price, they would eventually have to sell back at lower prices than they bought.

_____ 56. The uniformity-of-wages principle

- a. is that there is a tendency toward a uniformity of wage rates for workers of the same degree of skill and ability
- b. exists because of the preference of workers for higher wages rather than lower wages
- c. exists because the movement of workers from the lower-paying fields into the higher paying fields reduces the supply of labor and raises its wages in the initially lower-paying fields and increases the supply of labor and reduces its wage rates in the initially higher-paying fields
- d. all of the above

_____ 57. The operation of the principle that there is a tendency toward a uniformity of wage rates is unrealistic because it requires that forty-year olds be willing to change careers for ten or twenty percent pay differences.

_____ 58. The uniformity-of-wages principle gives the consumers the power to determine the relative size of the various occupations simply by changing their pattern of buying and abstention from buying.

_____ 59. Positives or negatives, such as safety or danger, pleasantness or unpleasantness, and low or high costs of training, associated with the different types of jobs serve to create permanent inequalities in wage rates at any given level of skill and ability, with the wages where the positives prevail being correspondingly higher and the wages where the negatives prevail being correspondingly lower.

_____ 60. Permanent inequalities of wage rates exist between unskilled, skilled, and professional-level workers, because of the inability of those in the lower categories to cross over into the higher categories and thereby change the relative supplies of the different types of labor.

_____ 61. The inability of the less capable to cross over into the ranks of the more capable helps to explain the extraordinarily high incomes of star performers.

_____ 62. The effect of a rise in the demand for the products and services of skilled labor relative to those of unskilled labor reduces the disparity in the wages of the two groups.

_____ 63. Where changes in the pattern of the consumers' buying and abstention from buying are unable to effect a change in the relative size of the various occupations, because of the inability of the wage earners to move from occupations in lesser demand into those in greater demand, the effect is to change the relative wage rates of the occupations.

_____ 64. Relative consumer demand in the face of fixed supplies is what explains

- the incomes of star performers relative to those of everyone else
- inequalities in the wages of unskilled, skilled, and professional-level workers
- both (a) and (b)

_____ 65. The profit motive is consistent with paying blacks and women less than whites and men for doing the same work, because more profit is earned by paying lower wages.

_____ 66. The fact that, other things being equal, more profit is earned by paying lower wages than

higher wages leads to an increase in the demand for the workers earning the lower wages and a decrease in the demand for workers earning the higher wages, which serves to raise the wages of the former and lower the wages of the latter, until they are equal or the difference is imperceptible.

_____ 67. The profit motive is consistent with charging blacks higher rents for the same housing and higher prices for the same goods, because, other things being equal, higher rents and higher prices mean higher profits.

_____ 68. Cost of production influences the prices of products

- indirectly by causing production to be increased and prices to fall where price exceeds cost by more than enough to provide the going, competitive rate of profit, and by causing production to decrease and prices to rise where price does not exceed cost by enough to provide the going, competitive rate of profit
- directly, in that large low-cost producers with capacity to spare are in a position to set prices close to the costs of their less efficient rivals, who are thereby normally prevented from earning high profits and expanding, while they themselves can earn substantial profits on the basis of their lower costs of production
- both (a) and (b)

_____ 69. Cost of production at any given stage of production

- always reduces to a sum of prices times respective physical quantities of the various means of production
- consists in part of prices determined by further costs of production and of wage rates and other prices determined by demand and supply
- is more and more resolvable into wage rates and other prices determined by demand and supply as one goes further back in the chain of supply
- all of the above

_____ 70. Cost of production

- provides the ultimate explanation of prices
- cannot be an ultimate explanation of prices, but leads back to supply and demand as the ultimate explanation of prices

PART B. ALLOCATION PRINCIPLES

_____ 71. This is a multipart question. Match the following items with a "C" if their prices are normally determined directly on the basis of cost of production and with a "D" if their prices are directly determined by demand and supply.

- agricultural commodities between harvests
- skilled and unskilled labor

- goods at retail
- second-hand goods
- manufactured or processed goods
- paintings by old masters
- scrap iron

_____ 72. The quantity of money determines the absolute height of goods and services in limited supply and consumer preferences determine their relative height.

_____ 73. In a free market, the prices of consumers' goods in limited supply are set high enough to limit quantity demanded to the supply available and thereby prevent shortages of such consumers' goods.

_____ 74. The setting of prices in the manner described in the previous question

- a. serves the interests of the sellers and the rich but harms the interests of the buyers and the poor
- b. serves the self-interests of buyers as well as sellers, and of poor buyers as well as rich ones
- c. makes the distribution of goods and services in limited supply take place in accordance with a combination of relative wealth and income and relative need and desire
- d. all of the above
- e. (b) and (c)

_____ 75. In a free market, the prices of factors of production in limited supply

- a. are high enough to limit the quantity of such factors demanded to the supply of them available
- b. carry through as costs of production to the products of such factors and serve to keep the quantities of them demanded within the limit of the supply of the factors of production available
- c. are in the self-interest of buyers, including employers, no less than sellers
- d. serve to bring about a distribution of the benefit of the factors in accordance with a combination of the relative wealth and income and relative need and desire of the ultimate consumers
- e. serve to accomplish the added dimension of distribution of factors of production among the competing uses of them in the production of various products, e.g., the distribution of crude oil as between the production of gasoline and the production of heating oil
- f. all of the above

_____ 76. In a free market, the distribution of the factors of production among their various uses takes place in accordance with a process of bidding among the different needs, desires, and purposes of one and the same set of consumers.

_____ 77. In a free market, the factors of production are allocated to their most important uses, in accordance

with the bidding of the consumers for their products.

_____ 78. The concept "most important uses" of a factor of production is

- a. a given fact
- b. a variable range determined by the supply of the factor available

_____ 79. A free market operates to maximize gains and minimize losses in connection with increases or decreases in the supply of a factor of production by means of

- a. withdrawing a factor of production in diminished supply or in additional demand from the least important of its previous uses, i.e., its previously marginal uses
- b. allocating the newly available supply of a factor of production that result either from a decrease in demand for it or from an increase in its overall supply to the most important of its previously sub-marginal uses
- c. both (a) and (b)

_____ 80. By prohibiting the rise in oil prices, price controls during the Arab oil embargo led to submarginal uses of oil being able to go on obtaining supplies at the expense of far more important uses of oil.

_____ 81. Free market prices, which are high enough to end shortages, prevent hoarding.

_____ 82. Cost of production signifies a combination of the quantities and value of the factors of production that are made unavailable for alternative uses. The lower the cost of producing any given item, the larger the quantities and the more valuable the factors of production left available for use elsewhere in the economic system.

_____ 83. Cost calculations operate to lead each product to be produced by methods that least impair production in the rest of the economic system.

_____ 84. In a free market, a reduction in the supply of a factor of production causes a rise in its price and efforts on the part of those faced with the higher price to find substitutes and to respond by reducing their consumption of the more expensive item(s) in ways that are least costly to themselves.

_____ 85. Price controls during the Arab oil embargo prevented the economic system from adopting a rationally planned response to the reduction in oil supplies.

Answers to Questions 1-85 on Chapter 6

| Question # | Correct Answer | Question # | Correct Answer | Question # | Correct Answer |
|------------|---------------------------|------------|----------------|------------|--|
| 1 | F | 31 | c | 61 | T |
| 2 | T | 32 | T | 62 | F |
| 3 | T | 33 | T | 63 | T |
| 4 | a) 10%, b) 10%, c) 10% | 34 | T | 64 | c |
| 5 | d | 35 | T | 65 | F |
| 6 | T | 36 | f | 66 | T |
| 7 | T | 37 | T | 67 | F |
| 8 | T | 38 | d | 68 | c |
| 9 | T | 39 | T | 69 | d |
| 10 | c | 40 | F | 70 | b |
| 11 | T | 41 | T | 71 | a) D, b) D, c) C, d) D e) C, f) D g)D |
| 12 | c | 42 | T | | |
| 13 | T | 43 | T | | |
| 14 | b | 44 | d | | |
| 15 | T | 45 | T | 72 | T |
| 16 | T | 46 | T | 73 | T |
| 17 | T | 47 | T | 74 | e |
| 18 | T | 48 | e | 75 | f |
| 19 | T | 49 | T | 76 | T |
| 20 | c | 50 | d | 77 | T |
| 21 | F | 51 | T | 78 | b |
| 22 | up to \$10 | 52 | d | 79 | c |
| 23 | \$2.50 | 53 | T | 80 | T |
| 24 | c | 54 | T | 81 | T |
| 25 | c | 55 | T | 82 | T |
| 26 | c | 56 | d | 83 | T |
| 27 | T | 57 | F | 84 | T |
| 28 | T | 58 | T | 85 | T |
| 29 | T | 59 | F | | |
| 30 | c | 60 | T | | |