Chapter Thirteen: The Marginalist School – Jevons, Menger, von Wieser, and Von Bohm-Bawerk (pg 211 - 230)

William Stanley Jevons

English, 1835-1882,
- Born in Liverpool, worked in Australia as an assessor
- Resentful that his new ideas were not accepted/rewarded
- Died young, (drowned)

Publicly stated that Ricardo was wrong, and thus mill was wronger

Broke with them most notably on the theory of value
- Classical economists – a pearl had value because of its costs
  - Since diving for pearls was expensive, pearls are expensive

Jevons disagreed, value was a function of utility
- The value of pearls depended on utility, which was declining
- Since there were not many pearls, each existing one had high utility
  - And more were not produced, because the value was declining

In modern terms
- Jevons thought the classicalist were confused on price and quantity

Theory of diminishing marginal utility

Utility cannot be measured directly
Utility cannot be compared between people (except he was inconsistent)
Utility can be indirectly observed, by looking at people's behavior
Individuals CAN compare utility of successive goods,
Individuals CAN compare utility of different goods to themselves

(**Insert Graph 13a here)**

Jevons differentiated between total utility and "final degree of utility"
- Final degree of utility, or marginal utility

Argued that all goods have declining marginal utility
- This is only true for interesting ones…..

Note: Jevon's had finally solved the water/diamond paradox
- Smith/Ricardo had thought water and diamonds had two values
  - The exchange value, the use value, the cost of production..
- Jevons: they had total utility and marginal utility
  - The total utility of water was higher
  - The marginal utility of diamonds was higher
- And it was marginal utility that was determining price

Rational choice: The equimarginal rule

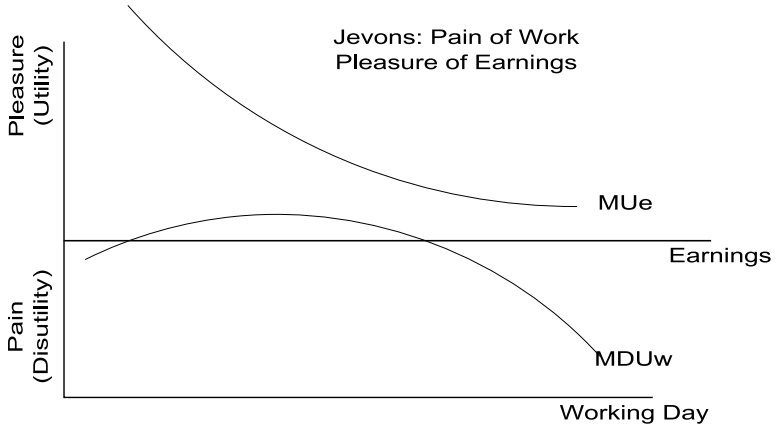
Given the theory of diminishing marginal utility
People will try and equate the marginal utility of goods consumed
- But they must take price into account as well

So MUx/Px = MUy/Py…. = MUn/Pn

Jevons on Work vs. Leisure (pain/pleasure)

How much work will a person do?

In Jevons theorized, that this too was subject to marginal analysis



In the above, the horizontal line is our earnings, a constant wage times hours of the day worked.

MUe is the marginal utility of earnings; it is declining for the normal reasons
MDUw is the marginal disutility of work.

Any point above earnings is utility, any point below it represent disutility,

Analysis of graph……

Other Topics addressed by Jevons

Had a rudimentary theory of capital and distribution
Made significant contributions to the theory of Gambling and Insurance
Showed that gambling in a fair game does not pay
Business cycle theory: he came up with the sunspot theory
Supply side explanation; post hoc, ergo proptor hoc error
(after this, thus because of this) commonly called false causality
Created price indexes, for use in calculating inflation.

Jevons on Public Policy

Skip for now….

Carl Menger

1840 – 1921, Galacia, studied in Vienna, Prague and Cracow
Published principles of Economics in 1871
Wanted to produce a great system of economics, so published little
But was incredibly influential throughout central/eastern Europe
Basically created the Austrian School of Economics

Theory of Value

Had a theory of value similar to Jevons

But deliberately did not make it mathematical

Note: review chart……

Theory of Imputation

Menger originated the idea of imputation in pricing factors of production

Question: what determines the prices of "higher order goods"

In classical economics, it was value – determined by labor, work, etc.

For Menger, higher order goods again satisfied consumer wants

Though they did so indirectly

Menger was attacking labor theories (and other) of value

A higher order good is not valuable because of the resources (costs) put into its production……

It is valuable because of the goods we expect to be able to get out of it

Land, Capital, raw materials – all are valuable because of what they can produce – not because of what they cost.

Menger then went on to expand marginalism into production. Assuming diminishing marginal returns, he showed that inputs would be used to the point where their marginal contribution to production equaled their marginal costs.

This undermined the whole theory of the Iron Law of Wages – since labor was an input, it would be employed to the point where its marginal value was the equal of the marginal value of land and capital, and this value could be above or below the sustenance level.

Friedrich Von Wieser

1851 – 1926, Austrian, Vienna and Prague

Read Menger, quit the law and became an economist

Most noteworthy for giving us the term marginal utility, and opportunity cost

Exchange Value vs. Natural Value

Like Menger, had some confusion on total vs. marginal utility

Skip for now….

Opportunity Cost

The utility one gets from goods is subjective – everybody now believes that….

So would not the disutility one gets from working also be subjective?

The cost of production is thus also subjective

Calculating out these costs though….

Primarily important in theories of entrepreneurship

Opportunity costs had been anticipated, by Benjamin Franklin and Frederic Bastiat

Bastiat: "that which is seen and unseen" or the Broken Window Paradox

Eugen Von Bohm-Bawerk

(1851-1914, again Vienna, married to Wieser's sister

Generally advanced economics incrementally (developing Menger's Ideas),

But noteworthy for his work on interest

The Premium Theory of Interest

Interest rises for three reasons

Present Orientation: we value the present more than the future

We do this because of a "defect of the imagination", i.e. irrationality

Only example of irrationality Bohm-Bawerk believed it

Now, we would call this time-preferences

Expectations of Rising Wealth

We would borrow and pay interest for present consumption, because

We expect to be wealthy in the future,

and that wealth is subject to diminishing marginal utility

Roundabout Production

Adding capital takes time, but leads to higher production

Interest tells us how costly it is to borrow today for future production

And thus will effect decisions about how to produce

This turned the time spent producing a good into a variable…

Previously, it was treated as a technological constant