

Preface

Introductory courses of microeconomics normally start with partial equilibrium analysis, consumer surplus analysis in particular. In order not to torture students, consumer surplus for a given individual is quite often introduced simply as a cardinal utility that is measured in income, which is taken to be interpersonally comparable. Then, we teach efficient allocation of resources as maximization of social surplus, which is the sum of consumer surplus across individuals minus social cost of production.

Then, we move on to intermediate or advanced/intermediate courses, in which we introduce the concepts of indifference curves and ordinal utility defined over multiple goods, Edgeworth box, Pareto efficiency, contract curve (or Pareto set), and general equilibrium with simultaneous determination of price and income, *as if nothing has been taught before that*.

In order to teach imperfect competition or incomplete information then, which is difficult to teach in the general equilibrium framework not just because of pedagogical hardness but also because of analytical limitations, we come back to the partial equilibrium framework, calculate

deadweight loss and teach how to extract surplus or how to restore the loss, *again as if nothing has been taught before that.*

Such gap between partial equilibrium analysis and general equilibrium analysis is paid little attention, not only at pedagogical level but also at the academic level, especially, in the era in which academic economists are demanded to provide more “useful applications.”

It has not been made clear, however, even to the audiences who should know it, in what sense partial equilibrium analysis is indeed a “part” of general equilibrium analysis.

The problem is pervasive. Those who leave the economics subject after introductory courses tend to get an understanding that “money can buy” is the everything of economics, and that maximization of social surplus alone determines an economic outcome uniquely and “scientifically,” whether they decide to be pro or con about it when leaving.

According to the “money can buy” understanding, if an item or an action is “really necessary” for an individual she should be able to pay for it. This tautological assertion is coming from a confusion between being able to pay and being willing to pay, while the equivalence between the two requires a certain condition. And the criticism to it, namely “money can’t buy,” would be understood as a reaction to this confusion at least, while I wouldn’t say that it is standing on the same confusion.

As economists who have learned general equilibrium theory, we know that such confusion is due to a confusion between income effect and substitution effect, and even when “money can buy” is empirically wrong what should be blamed is a wrong application of the particular condition, or applying the condition without knowing what it is, or not even being aware of relying on the condition, and not economics itself at methodological level. However, in introductory courses, we are in fact teaching that “money can buy.”

We also know that maximization of social surplus alone does not determine an economic outcome at a general equilibrium level, as maximization of surplus alone leaves it totally undetermined how we should distribute the maximized social surplus, and as Pareto efficiency alone is totally silent about distributional properties of allocations. However, in introductory courses, very little emphasis is put on this apparent determinacy.

This book aims at providing a bridge over the gap, or at least illustrating the natures of the gap. It summarizes researches, old and new, which I view are deeply relevant to the gap, as well as the materials which are standard at graduate/upper-division undergraduate level but I guess are not fully shared by the intended audiences. I apologize, if the way how I approach to those is selective and I insist too much on my own researches, though.

I also hope that this book serves as a “teacher’s manual,” which helps teachers to have a better understanding of the gap, and provides intuitive stories on the assumptions underlying the partial equilibrium analysis.

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