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The Microeconomic Basis

With 56 Figures and 7 Tables



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Preface

When one gets older, one looks at the science in which one has been working for a long time from a certain distance such that the general approach, the contours of the whole and the connections to other parts of the social sciences come to the foreground whereas the elaboration of the details must be left to younger colleagues. This applies also to this book: details are left to younger colleagues – if they find it worthwhile to try this new approach. I know quite well that the ideas presented here are incomplete and more in the spirit of a research program than a final product in itself. But time runs out. I personally think that this new road is worthwhile trying, but, of course, I, as the author, am not unprejudiced. On the other hand, after a certain age one is not so sensible to be torn to pieces by his critics, nature will do that anyway.

I present here only the basic ideas, the “hard core” of the theory and leave out most of the definitional relations which close the system. I leave that to the interested reader and to the scholar who wants to work with the system.

There are some repetitions in the book. This is done in order to make the single sections of the book as much self contained as possible and in order not to compel the reader to read the whole book to understand some points he is interested in. Notations are only consistent in each section, but not between sections.

In this book only the building blocks of a general dynamic disequilibrium system are considered: the theory of households, firms, banks, of the educational system, the government, and the formation of prices, wages, and interest rates. The different systems are not always compatible. They must be specified and simplified to a certain degree to form a consistent general theory. This will not be done here.

After these general remarks, I should like to come to the special principles that underlie this “new” approach – not totally new, of course, each scientist today stands on the shoulders of giants of the past.

1. The Walrasian System is to a large extent the theoretical base of the leading neoclassical school in economics as far as the static approach is concerned. But the work of Sonnenschein (1972) and Debreu (1974) showed that this system does not restrict the possible outcomes under the realistic assumptions that there are more households than commodities in the economy, and (following Popper) a theory which admits everything cannot be accepted as a scientific theory. The theory needs more structure to become meaningful. But this means that the theory has to be tailored to certain types of economies, e.g. to the economies of special western industrialized countries.

The background of the model is a European type economy. More structure means inevitably: concentrating on special features which may not be characteristic for other economies.

2. The Walrasian general equilibrium system is static. It does not consider the monetary system, the government and foreign countries. We present a model where the monetary system and the government are fully included. But (for simplicity) we neglect foreign countries.
3. The assumptions of utility maximization of households and (to a smaller degree) of profit maximization of firms which underlie the “normal” neoclassical theory came lately under heavy attack, often connected with criticism of the high degree of abstraction used in the economic theory, see e.g. Mark Blaug “The disease of formalism in economics, or bad games that economists play”, *lectiones jenenses*, Jena 1998, and the literature cited in this paper.

Substantial criticism came also from the sociological as well as from the psychological point of view, confer Renate Mayntz “Rationalität in sozialwissenschaftlicher Perspektive”, *lectiones jenenses* number 18, Jena 1999; from the point of view of experimental economics the work of Reinhard Selten may be cited. This criticism is mainly directed against the existence of utility functions for the households and the assumption of maximizing this function in order to derive demand and supply functions. In an analogous way though to a smaller degree the assumption of maximizing profits by firms has been criticized.

In our approach there is no utility function. The person which has to decide on something (e.g. the household on consumption expenditures) does it by considering different points of view (e.g. the satisfaction of wants, possible situations in the future, moral obligations) and weighing them. The weights change under the influences of other persons and of ideologies, philosophies and theologies. This approach allows to include the influence of the spiritual side of life in economic analysis and conversely shows the influence of economics on the spiritual side.

The suggested decision criteria are somehow in line with the corresponding theories in sociology and psychology: there are almost always different points of view or principles of judgement to be taken into account when a person or an institution wants to reach a decision. The decision makers try to find a solution to their problem which somehow considers all different points of view which he or she finds relevant in this case. The optimal decision comes out as a result of compromise between these principles.

4. The Walrasian system is constructed to demonstrate the economic situation in a fictitious state of general equilibrium which will never be reached in practice. In our approach the system is always in disequilibrium, expectations will (almost) never come true, but there is an (always frustrated) tendency to come to an equilibrium. The situation is like that of a dog chasing a hare: if the dog comes near to the hare, the hare makes some unexpected turn, and the dog stays again far behind its target.

5. The Walrasian system states the theoretical result of the economic interdependence of many households and firms under the assumption of perfect competition, but it cannot show how this result may be reached in practice. The auctioneer who announces prices and prohibits all transactions till a general equilibrium is reached is an unrealistic construct which has no equivalence in practice. In our approach, all prices are made by decisions of persons (given their information); there is no impersonal apparatus which determines prices or other economic variables.
6. The “normal” economic theory assumes continuity of all functions which implies that choices have to be made between infinitely many alternatives – which is impossible in practice. We do not make this abstraction: everything is finite in our approach – as the number of particles in the whole universe is finite. In the computer age we should not be afraid of large numbers, though in our approach the person has to choose only between few known alternatives. This is not always mentioned explicitly. Thus we also use normal analysis but only the integers (in general: the nearest integer, if the solution is not discrete) have a meaning.

The microeconomic system gives an insight into the functioning of a market economy, but it is not operational in the sense that it can be used as guide for economic policy. One needs a macroeconomic system for this purpose. But it is hopeless to derive a macroeconomic system directly from the microeconomic one. The macroeconomic system which I have in mind depends on the distribution of the characteristics of households and firms which are put forward in the microeconomic system. The derivation of the macroeconomic system is an econometric problem. Some suggestions can be made on the structure of this system. They must be checked. Unfortunately, I cannot do that myself. But perhaps some scholars may find the system suggested in this book interesting and promising enough to complete it formally and to test the macroeconomic version.

Finally I want to thank Werner Hildenbrand, Speaker of the Special Research Center (Sonderforschungsbereich) 303 at Bonn University, and Peter Schönfeld, head of one of the projects of this Research Center, for accepting this research as part of the work of this center and providing the necessary office space and the means for employing student assistants (studentische Hilfskräfte); I only name a few: cand. rer. pol. Menten, Schmitz, Dirlenbach, Zimmermann, Richter, Heinrichs, Radermacher, Klar, Claßen who prepared the manuscript from my hand writing. Markus Richter put the manuscript in a shape which made it publishable at Springer. I also wish to thank Dr. Müller from the Springer Verlag. Without his encouragement and promise to publish the manuscript it would not have been written. And finally I want to thank all friends and relatives who by their love and friendship gave me the force to write this book.

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