

Methodology for a New Microeconomics

The Critical Foundations

LAWRENCE A. BOLAND

*Simon Fraser University,
Burnaby, British Columbia, Canada*

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To my students from Milwaukee to
Vancouver who question and criticize when
they cannot understand.

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Preface

Secondary roads are preferred... It was some years ago that [we] first began to catch on these roads.... [T]hese roads are truly different from the main ones. The whole pace of life and personality of the people who live along them are different. They're not going anywhere. They're not too busy to be courteous. The hereness and nowness of things is something they know all about. It's the others, the ones who moved to the cities years ago and their lost offspring, who have all but forgotten it. The discovery was a real find.

I've wondered why it took us so long to catch on. We saw it and yet we didn't see it. Or rather we were trained *not* to see it. Conned, perhaps, into thinking that the real action was metropolitan and all this was just boring hinterland. It was a puzzling thing. The truth knocks on the door and you say, 'Go away, I'm looking for the truth', and so it goes away. Puzzling.

Robert Pirsig [1974, pp. 4–5]

Over the last twenty-five years an ever widening gap has appeared between what we teach economics undergraduates and what we expect graduate students to understand. The gap is due entirely to our graduate theory classes since the microeconomics we teach our undergraduates has not changed significantly from what we taught in the late 1940s. Today the gap between what we teach at these two levels is such that it amounts to a contradiction.

Graduate microeconomic theory is considered a 'new microeconomics'. Graduate students are supposed to be concerned with the 'disequilibrium foundations' of equilibrium economics rather than with the static descriptions of a market where demand equals supply. The old microeconomics that we teach undergraduates is concerned with only a simple appreciation of the virtues of a world governed by a market system – that is, an appreciation that if everyone were guided by market determined prices and were satisfied by making their decisions independently, we would have an equilibrium which is the 'best of all possible worlds'. While graduate students are supposed to understand 'disequilibrium economics', undergraduate students are supposed to be

satisfied with equilibrium models alone.

This gap is at best unfortunate and at worst educationally unjustifiable. If we have learned anything over the last twenty-five years it is that we have been teaching undergraduates more about a fantasy world than the world we see outside our window. Unless we know why an economy is in a state of equilibrium, we know very little. Moreover, unless we know that the world outside our window is in a state of equilibrium, there is little that can be explained. We are leaving our undergraduate students woefully unprepared to deal with the real world – despite the usual promises made to them.

Teachers of undergraduate economics almost always think it is necessary to simplify the idea of equilibrium so that students can learn the ‘important’ ideas. However, the simplification seems to ‘throw the baby out with the dirty bath water’. The simplification here is the view that a market equilibrium is just the equality between demand and supply. A more complex view recognizes that it is possible to think of an equality of demand and supply in a market where demand curves are upward sloping and supply curves are downward sloping. Everyone will immediately dismiss this observation by saying that it is only concerned with an ‘unstable equilibrium’. But anyone who has used the idea of an equilibrium in other disciplines will be puzzled by the concept of an ‘unstable equilibrium’ since it is self-contradictory. To avoid the contradiction, we must appreciate that any equilibrium-based explanation of the economy must imply a ‘stable equilibrium’. The economics we teach undergraduates fails to provide such an explanation. It is for this reason that graduate students have to worry about what is called ‘stability analysis’.

As a student, economic theory made little sense to me until I was introduced to stability analysis. And when I began teaching economic theory I found it easier to explain the reasons for our assumptions if I first explained the basis for the stability of the usual textbook market – the market with downward sloping demand curves and upward sloping supply curves. In particular, I found it much easier to explain why so much of consumer theory is concerned with showing that, even though individuals make their consumption decisions autonomously and independently, the market demand curves will always be downward sloping whenever consumers are optimizers. It is also easier to see why microeconomics must imply that supply curves are upward sloping as a consequence of the nature of the scarcity that faces profit maximizing producers. What the textbook market ensures is the possibility of truly autonomous individual decision-making. I tried to demonstrate this approach to teaching microeconomics in a textbook manuscript [Boland, 1967], but publishers, while saying that it was clearly written, never thought there was a market for it. I found this puzzling since

microeconomics makes little sense without an appreciation of elementary stability analysis.

Today, I think I can understand where I went wrong. An approach to teaching microeconomics that stresses questions of stability analysis must promote a self-consciousness about explanatory methodology. What I had failed to appreciate was that most economists consider methodology to be a waste of time. In my 1982 [Boland, 1982a] book I showed why methodology is an essential part of the economics we teach. But that book does not address the more elementary problems of stability analysis that can be appreciated by undergraduate economic theory students.

In this book I offer a critical examination of the neoclassical model which typically fails to include an explicit stability analysis. I show that much of the sophisticated theoretical literature over the last thirty years can be understood as *ad hoc* attempts to overcome the deficiencies of models that are limited by the absence of stability analysis. At the end of this book I explain what we must do to update undergraduate theory, and above all, to develop a truly individualist version of microeconomics that is both complete and consistent with the methodological principles of all neoclassical models.

L.A.B.

Burnaby, British Columbia

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