

General Equilibrium – NOT!

by Anne Emerson

We are now on page nine of Economic Ideas for General Readers, and I will tell you a secret. General Equilibrium is not “Principles of Economics” – which latter is what BBA business students learn. It’s not even “Managerial Economics” which is what MBA students learn. It’s not even what undergraduate students of Development Economics learn. And page eight in this series explained what theorists of International Economics get wrong, regarding the real-world practice of international business. All of these people can re-learn their basic beliefs without understanding the math that goes into General Equilibrium Theory. All we have to do is convince them it’s necessary.

I am telling you General Readers something that only graduate students of Economic Growth Theory would be expected to understand. I think you can handle it! What do you think? Are you still reading? Then stay with me, please. Let us ALL soon start fixing the system, each in our own way.

(Are you still waiting for me to affirm your belief that, if the price goes up, people buy less and if the price goes down, people buy more? You knew that all along, didn’t you? So, let us leave the economists’ version of Supply and Demand until tomorrow. Jam tomorrow, lest anyone forget.) But PLEASE remember what you have learned about elastic revenues: For some products, a reduction in price increases the total take; for other products, a reduction in price decreases the take and necessitates budget cuts. *Cheaper is not necessarily better, for those types of products. It’s often worse.*

General Equilibrium is the mathematics of economics that puts the whole crazy world into balance. We first encountered it as an idea on page eight of this series. Everything interacts, in this global system – all the fountains; all the businesses; all the households; all the products; all the services, including government services; all the schools, universities, computers, robots, electronics, minerals, adults, children, farms, cities, past, present, and future; even the whole global economy. *In theory*, when everything interacts via what people sell (supply) and what people buy (demand), with competition to make everything better and cheaper, and ongoing technological progress helping with that, we get a Utopian balance, or “General Equilibrium”! (The best of all possible worlds...)

NOT! General Equilibrium Theory has an Achilles Heel (ask an ancient Roman about that!). If other economists agree with me, then everyone can start to rearrange systems and processes, and most of you can skip learning economics. Other types of economies – including the Central Planning System of the former Soviet Union – can work, not because they are perfect, but because after a while we get to know what helps and what doesn’t, and then we TWEAK the system. Some economists know what “From the Achieved Level” means. You may think of the flywheel in the book, “Good to Great.” We prefer not to stop a flywheel and start it again. We prefer to make little tweaks so it runs better next time around. But only if our flywheel (our business, or our nation) doesn’t collide with other flywheels. Sparks may fly and wars may start, if we forget about others’ flywheels.

So, here’s what the economic mathematics-of-everything needs to tweak. Inventive activity is motivated by the likelihood of monetary gain (there’s a book about it*). That is, inventions (ALL sorts) - under current rules - have brought us to this place. If we make money when the price goes down (cutting edge), and lose money when the price goes down (necessities), then we don’t solve budget challenges where necessity still survives, albeit with difficulty! Oops! Page Nine is now full.

*Schmookler, Jacob, 1976, “Invention and Economic Growth,” Harvard University Press, Cambridge and London