Lecture 11: Marginalists – the Walrasian school

We stopped in the middle of our treatment of Marshall, so this is where we begin. Finishing this, we turn to the next school of marginalists, connected with Walras.

The approach towards economics, and in particular microeconomics (the distinction between micro and macro came much later) proposed by Walras and his followers differs considerably from that of the English school as well as from the Austrians (next lecture), the main distinguishing feature being the *general equilibrium* approach to economic analysis. This is also pointed out in E&H, and they rightly characterize Marshall and Walras as the main founders of modern economics. While the Marshallian approach was well received and accepted already at his time, that of Walras was not fully appreciated (or indeed understood) in Walras' lifetime, its major breakthrough occurring only in the 1950s. The two different ways of doing economics can be identified today, each having had its ups and downs.

The description of what is meant by a the general equilibrium approach is somewhat longwinded in E&H, but it is a useful introduction for those not having been exposed previously to the theory (the Walrasian approach is presently in a period of downturn, and general equilibrium is slowly being filtered out of the mainstream microeconomics textbooks, being considered as too complicated). For our purpose, it is important to notice how Walras saw the workings of the market where demand is to meet supply. Here Walras assumes a single price for each commodity (assuming the conditions for Jevons' "principle of indifference") which is used by buyers and sellers to determine demand and supply (so that the market is one of perfect competition), and only the equilibrium prices will remain. Our textbook has a good treatment of the differences occurring when either price (Walras) or quantity (Marshall) is considered as the independent variable.

The detailed mechanism by which the equilibrium prices of all commodities are established with Walras (the celebrated tâtonnement process) is of course unrealistic and it later turned out that it wouldn't solve the problem except in special situations. Behind the technical problems (see Lecture Note 11) there is an even deeper one of whether the Walrasian equilibrium concept focussing on the equilibrium and neglecting disequilibria is sufficient for understanding the function of markets.

H&E rightly follow up on Walras by a treatment of Pareto, who was his student and successor in Lausanne Vilfredo Pareto is important. He is important not only for introducing the concept of Pareto optimality which has become standard in welfare theory, but also for being the first to point out that utility is an *ordinal* measure (comparison can be made only of size) rather than as implicitly assumed by earlier authors a *cardial* measure (also utility differences can be compared).

H&E mensions that the Walrasian approach was actively developed in Italy. It had followers also in other countries, e.g. in Portugal, but not in England (or Germany), at least not until much later.

We read: H&E, chapter 17.