and Menger, wanted to replace the cost of production theory of value with an almost exclusive emphasis on the role of demand and marginal utility.

2. **Carl Menger:**

- The founder of the Austrian School of Economics which later took the foundations of marginalism and developed them to their extreme.
- Menger attacked the labor theory of value, expressing his view that the factor determining the value of a good is not the amount of work nor other goods needed to produce it, but the importance we place on the basis of the satisfaction we believe it can offer.

3. **Leon Walras:**

- Another co-founder of marginalism and theory of utility. He made his major contribution to economics, general equilibrium theory, on which all demands are interrelated into a coherent set of relationships.
- This general equilibrium was reached by changes in price that would gradually approximate supply and demand until a steady state is reached.
- Walras's disciple Vilfredo Pareto lays claim to be one of the fathers of modern welfare economics.
- Pareto's answer to the question of evaluating the efficiency of resource allocation was straightforward: a change in resource allocation will improve welfare if one person can be made better off with no other person's being made worse off. An ideal or optimum distribution of scarce resources, a Pareto optimum, is defined as one in which it is impossible to make someone better off without making someone else worse off.
- Before Walras, economists had made little attempt to show how a whole economy with many goods fits together and reaches an equilibrium. Walras's goal was to do this. He failed but he took some major first steps. First, he built a system of simultaneous equations to describe his hypothetical economy, a tremendous task, and then showed that because the number of equations equaled the number of unknowns, the system could be solved to give the equilibrium prices and quantities of commodities. The demonstration that price and quantity were uniquely determined for each commodity is considered one of Walras's greatest contributions to economic science.
- But Walras was aware that the mere fact that such a system of equations could be solved mathematically for an equilibrium did not mean that in the real world it would ever reach that equilibrium. So Walras's second major step was to simulate an artificial market process that would get the system to equilibrium, a process he called "*tâtonnement*"
- General equilibrium theory in macroeconomics shows how supply and demand in a multi-market economy interact and create an equilibrium of prices.

NEOCLASSICAL ECONOMICS:

- Neoclassical economics was the birth of mathematics as an inescapable tool for constructing economic theories. It took the tools introduced by marginalism and saw them to construct much further reaching theories. → differentiation between micro and macro
- Hence, the central economic problem is the organization and allocation of scarce resources.

Commented [OA3]: A market system is in competitive equilibrium when prices are set in such a way that the *market clears*, or in other words, *demand and supply* are equalised. At this competitive equilibrium, firms' profits will necessarily have to be zero, because otherwise there will be new firms that, attracted by the profits, would enter the market increasing supply and pushing prices down. Following the *first fundamental theorem of welfare economics*, this equilibrium must be *Pareto efficient*.

Commented [OA4]: More factors are assumed to be held constant in partial equilibrium analysis than in general equilibrium analysis. Partial equilibrium analysis allows only a small number of variables to vary; all others are assumed constant. General equilibrium analysis allows many more variables to change.