

0.0. What is economics? What are the basic analytical benchmark (基準), framework (架構) and end-state (終極狀態) for economics?

The reality looks very complicated and is always in a state of flux to most observers or participants. How should one even begin to analyse the “mess that is lying out there”?

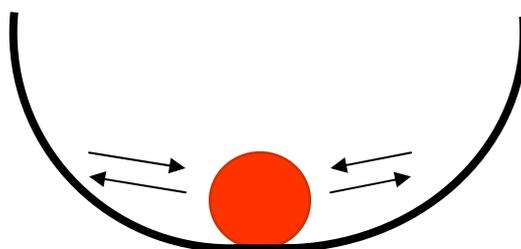
In the study of human behaviour, we always need a starting point (a point of departure), or a **benchmark**, or a **framework**. Moreover, we wish to know eventually the “ultimate” situation that the interactions of behaviour by different parties would end up in creating, i.e. the **end-state**.

Economics is often defined as the study of the “allocation of scarce resources” (匱乏資源的配置). But what kind of allocation should we aim at? The common answer seems to be “optimal allocation” (最優配置).

Then what is “optimal”? What is optimal to one may not be so to others. After a long period of research, discussions and debates, economists have come to view **“equilibrium”** as the most important “benchmark” in their analysis. The concept was actually borrowed from engineering in the 19th century.

Equilibrium: is defined as **a state of persistence (持續狀態) or rest (休止狀態)** under which there is no tendency for the status quo (現狀) to change, or to be changed by any involved parties, even if there is an exogenous disturbance (shock) that disturbs the initial state of rest.

An engineering analogy is: the small ball will always return to “rest” in the middle of the bowl.



In economics, market clearing (清貨) ($S=D$) is one such state, but it is **not** a pre-requisite to it. **This is actually one of central messages which I wish to pass on to you.** There are other states that can be called

equilibrium.

There are three basic analytical approaches in microeconomics:

1. The equilibrium (均衡) approach;
2. The disequilibrium (非均衡/失衡) approach; and
3. The economics of shortage (短缺).

Under the **equilibrium approach**, free competition by all economic agents and free interaction between the supply and demand sides are assumed. There are no constraints on the action of the economic agents, other their own *budget and cost constraints* (預算及成本制約). Under such a benign situation, the three concepts of equilibrium (均衡), optimality (最優) and efficiency (效率) are unified.

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Optimality refers to a situation that is the “best” to an economic agent: e.g. utility maximization for a consumer; cost minimization for a producer.

Efficiency refers to a market situation where **all possible welfare gains** from transactions are **fully explored**. In other words, there will not be further transaction possibilities that enhance the welfare of at least one market participant, keeping the welfare of all others unchanged.

Under the equilibrium approach, the concepts of equilibrium, optimality and efficiency are unified. In other words, we are looking at ***an optimal and efficient equilibrium***.

However, under the two other approaches, i.e. (2) The disequilibrium approach; and (3) The economics of shortage, **the three concepts of equilibrium, optimality and efficiency are NOT unified**.

This is another central message of the subject.