

LECTURE 6.1

THE NEOCLASSICAL MODEL

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Think of the firm as a set of production plans.



Strengths:

- Nice from math perspective, rigorous but rudimentary.
- Tractable: allows modelling how exogenous changes (shocks) affect firm behaviour, such as a change in wages or introduction of a tax
- Useful for thinking about strategic behaviours under imperfect competition

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Weaknesses:

- Says little or nothing about internal workings of firm, how decisions made etc
- Ignores conflicts within the firm. Many of those decision makers do not have a primary objective of maximising the value of the firm. They are, after all, individual economic agents with their own preferences. They can have different interests.
- No insight into what are the boundaries of the firm: no insight into mergers, splitting of firms into smaller firms, structure. Why do firms employ workers for some services, and contract for or purchase other services?