

# Contents

- 1 Introduction 1
  - 1.1 The Need for a Formal Unitary Methodological Basis for the Science of Economics 1
  - 1.2 The Axiomatic Method and the Development of a Formal Science of Economics 3
  - 1.3 Formalism and the Unity of Science 13
  - 1.4 Noteworthy Results 18
  - 1.5 Acknowledgments 32
  
- 2 The Axiomatic Method 34
  - 2.1 Axioms and Undefined Terms 34
  - 2.2 Rules of Inference and Definition 35
  - 2.3 Universal Terms and Theorems 36
  - 2.4 Theorizing and the Axiomatic Method 36
  - 2.5 Pitfalls in the Axiomatic Method 37
  - 2.6 Theories and Models 38
  - 2.7 An Example 38
  
- I Mathematical Logic I: First-Order Languages 41**
  
- 3 Meaning and Truth 43
  - 3.1 A Technical Vocabulary 43
  - 3.2 Logical Syntax 46
  - 3.3 Semantics 47
  - 3.4 The Semantic Conception of Truth 48
  - 3.5 Truth and Meaning 51
  
- 4 The Propositional Calculus 54
  - 4.1 Symbols, Well-Formed Formulas, and Rules of Inference 54

4.2	Sample Theorems	55
4.3	The Intended Interpretation	58
4.4	Interesting Tautological Structures	60
4.5	Disjunction, Conjunction, and Material Equivalence	62
4.6	Syntactical Properties of the Propositional Calculus	64
4.7	Proof of the Tautology Theorem	65
5	The First-Order Predicate Calculus	68
5.1	Symbols, Well-Formed Formulas, and Rules of Inference	68
5.2	Sample Theorems	72
5.3	Semantic Properties	78
5.4	Philosophical Misgivings	83
5.5	Concluding Remarks	86
<b>II</b>	<b>Mathematical Logic II: Theories and Models</b>	<b>89</b>
6	Consistent Theories and Models	91
6.1	First-Order Theories	92
6.2	Proofs and Proofs from Hypotheses	93
6.3	The Deduction Theorem	95
6.4	Consistent Theories and Their Models	97
6.5	The Compactness Theorem	98
6.6	Appendix: Proofs	100
7	Complete Theories and Their Models	107
7.1	Extension of Theories by Definitions	107
7.2	Isomorphic Structures	112
7.3	Elementarily Equivalent Structures	117
7.4	Concluding Remarks	123
7.5	Appendix	124
8	The Axiomatic Method and Natural Numbers	127
8.1	Recursive Functions and Predicates	127
8.2	Expression Numbers	131
8.3	Representable Functions and Predicates	134
8.4	Incompleteness of Consistent, Axiomatized Extensions of $T(N)$	137
8.5	The Consistency of $T(P)$	140
8.6	Concluding Remarks	144

- 9 Elementary Set Theory 146
  - 9.1 The Axioms of KPU 147
  - 9.2 The Null Set and Russell's Antinomy 151
  - 9.3 Unions, Intersections, and Differences 154
  - 9.4 Product Sets 156
  - 9.5 Relations and Functions 158
  - 9.6 Extensions 160
  - 9.7 Natural Numbers 161
  - 9.8 Admissible Structures and Models of KPU 168
  - 9.9 Concluding Remarks 169

### III Economic Theory I: Consumer Choice 173

- 10 Consumer Choice under Certainty 175
  - 10.1 Universal Terms and Theorems 177
  - 10.2 A Theory of Choice,  $T(H_1, \dots, H_6)$  181
  - 10.3 The Fundamental Theorem of Consumer Choice 186
  - 10.4 The Hicks-Leontief Aggregation Theorem 191
- 11 Time Preference and Consumption Strategies 194
  - 11.1 An Alternative Interpretation of  $T(H_1, \dots, H_6)$  194
  - 11.2 The Time Structure of Consumer Preferences 196
  - 11.3 The Rate of Time Preference and Consumption Strategies 201
  - 11.4 Consumption Strategies and Price Indices 207
- 12 Risk Aversion and Choice of Safe and Risky Assets 212
  - 12.1 An Axiomatization of Arrow's Theory 213
  - 12.2 Absolute and Proportional Risk Aversion 216
  - 12.3 The Fundamental Theorems of Arrow 219
  - 12.4 New Axioms 223
  - 12.5 An Aggregation Problem 225
  - 12.6 Resolution of the Aggregation Problem 228
  - 12.7 Appendix: Proofs 236
- 13 Consumer Choice and Revealed Preference 259
  - 13.1 An Alternative Set of Axioms:  $S_1, \dots, S_{11}$  260
  - 13.2 The Fundamental Theorem of Revealed Preference 263
  - 13.3 The Equivalence of  $T(S_1, \dots, S_{11})$  and  $T(H_1, \dots, H_5, \tilde{H}_6)$  271

## 13.4 Concluding Remarks 277

## 14 Consumer Choice and Resource Allocation 279

## 14.1 Competitive Equilibria in Exchange Economies 279

## 14.2 Resource Allocation in Exchange Economies 282

## 14.3 The Formation of Prices in an Exchange Economy 286

## 14.4 Temporary Equilibria in an Exchange Economy 294

## 14.5 Admissible Allocations and Temporary Equilibria 304

## 14.6 On the Stability of Temporary Equilibria 306

**IV Probability Theory: Chance, Ignorance, and Choice 309**

## 15 The Measurement of Probable Things 311

## 15.1 Experiments and Random Variables 312

## 15.2 Belief Functions 317

## 15.3 Probability Measures 326

## 15.4 Probability Distributions 334

15.5 Random Processes and Kolmogorov's Consistency  
Theorem 344

## 15.6 Two Useful Universal Theorems 348

## 16 Chance 351

## 16.1 Purely Random Processes 351

## 16.2 Games of Chance 354

## 16.3 The Law of Large Numbers 360

## 16.4 An Empirical Characterization of Chance 364

16.5 Chance and the Characteristics of Purely Random  
Processes 369

## 17 Ignorance 372

## 17.1 Epistemic versus Aleatory Probabilities 372

## 17.2 The Bayes Theorem and Epistemic Probabilities 378

## 17.3 Noninformative Priors 383

## 17.4 Measuring the Performance of Probability Assessors 388

## 18 Exchangeable Random Processes 391

## 18.1 Conditional Expectations and Probabilities 391

## 18.2 Exchangeable Random Variables 394

## 18.3 Exchangeable Processes and Econometric Practice 404

## 18.4 Conditional Probability Spaces 411

18.5	Exchangeable Processes on a Full Conditional Probability Space	415
18.6	Probability versus Conditional Probability	421
19	Choice under Uncertainty	422
19.1	The Decision Maker and His Experiment	422
19.2	The Decision Maker's Risk Preferences	424
19.3	Risk Preferences and Subjective Probability	428
19.4	Expected Utility	431
19.5	Assessing Probabilities and Measuring Utilities	439
19.6	Belief Functions and Choice under Uncertainty	445
<b>V</b>	<b>Nonstandard Analysis</b>	<b>457</b>
20	Nonstandard Analysis	459
20.1	The Set of Urelements $U$	460
20.2	A Model of the Axioms for $U$	463
20.3	Elementarily Equivalent Structures and Transfer	467
20.4	Superstructures and Superstructure Embeddings	470
20.5	Transfer and Superstructure Embeddings	474
20.6	Internal Subsets of $W(*R)$	477
20.7	Admissible Structures and the Nonstandard Universe	480
21	Exchange in Hyperspace	484
21.1	The Saturation Principle	484
21.2	Two Nonstandard Topologies	486
21.3	Exchange in Hyperspace by Transfer	494
21.4	Exchange in Hyperspace without Transfer	500
21.5	Concluding Remarks	506
22	Probability and Exchange in Hyperspace	508
22.1	Loeb Probability Spaces	508
22.2	Standard Versions of Loeb Probability Spaces	511
22.3	Random Variables and Integration in Hyperspace	514
22.4	Exchange in Hyperspace Revisited	520
22.5	A Hyperfinite Construction of the Brownian Motion	524
<b>VI</b>	<b>Epistemology</b>	<b>533</b>
23	Truth, Knowledge, and Necessity	535
23.1	The Semantical Concept of Truth Revisited	535

- 23.2 Truth and Knowledge 537
- 23.3 The Possibility of Knowledge 538
- 23.4 Different Kinds of Knowledge 546
- 23.5 Necessity and Modal Logic 556
  
- 24 The Private Epistemological Universe, Belief, and Knowledge 566
  - 24.1 The Private Epistemological Universe 566
  - 24.2 Logical Probabilities and Their Possible-World Interpretation 576
  - 24.3 An Axiomatization of Knowledge 583
  - 24.4 Other Concepts of Knowledge 605
  
- 25 An Epistemological Language for Science 612
  - 25.1 Simple, Autonomous Relations 612
  - 25.2 Analogy and the Generation of Scientific Hypotheses 615
  - 25.3 Induction and Meaningful Sampling Schemes 619
  - 25.4 Many-Sorted Languages 622
  - 25.5 Semantic Properties of Many-Sorted Languages 628
  - 25.6 A Language for Science 629
  - 25.7 A Modal-Logical Apparatus for Testing Scientific Hypotheses 633
  - 25.8 Appendix: Proof of the Completeness Theorem for Many-Sorted Languages 640

## **VII Econometrics I: Empirical Analysis of Economic Theories 645**

- 26 Empirical Analyses of Economic Theories 647
  - 26.1 Four Kinds of Theorems 647
  - 26.2 The Structure of an Empirical Analysis 651
  - 26.3 New Axioms and New Tests 666
  - 26.4 Superstructures, Data-Generating Mechanisms, the Encompassing Principle, and Meaningful Sampling Schemes 671
  
- 27 The Permanent-Income Hypothesis 679
  - 27.1 Formulation of the Hypothesis 679
  - 27.2 The Axioms of a Test of the Certainty Model:  $F_1, \dots, F_{17}$  683

27.3	Theorems of $T(F 1, \dots, F 17)$	687
27.4	Confronting $T(F 1, \dots, F 17)$ with Data	691
27.5	A Test of the Uncertainty Version of Friedman's Theory	700
27.6	Appendix: Standard Errors of Factor-Analytic Estimates	709
28	An Empirical Analysis of Consumer Choice among Risky and Nonrisky Assets	720
28.1	The Axioms of the Empirical Analysis	720
28.2	Arrow's Risk-Aversion Functions and the Data	726
28.3	Comparative Risk Aversion	732
28.4	Concluding Remarks	755
<b>VIII Economic Theory II: Determinism, Uncertainty, and the Utility Hypothesis</b> 759		
29	Time-Series Tests of the Utility Hypothesis	761
29.1	A Nonparametric Test of the Utility Hypothesis	762
29.2	Testing for Homotheticity of the Utility Function	766
29.3	Testing for Homothetic Separability of the Utility Function	768
29.4	Excess Demand Functions and the Utility Hypothesis	771
29.5	Nonparametric versus Parametric Tests of the Utility Hypothesis and a Counterexample	781
30	Temporary Equilibria under Uncertainty	785
30.1	The Arrow-Debreu Consumer	785
30.2	The Radner Consumer	789
30.3	Consumer Choice under Uncertainty	795
30.4	The Arrow-Debreu Producer	804
30.5	Entrepreneurial Choice under Uncertainty	807
30.6	Temporary Equilibria under Uncertainty	815
30.7	Appendix: Proofs of Theorems	827
31	Balance Growth under Uncertainty	840
31.1	Balanced Growth under Certainty	844
31.2	Balanced Growth under Uncertainty in an Indecomposable Economy	851
31.3	Balanced Growth under Uncertainty in a Decomposable Economy	862

<b>IX Econometrics II: Prediction, Distributed Lags, and Stochastic Difference Equations</b>	<b>869</b>
32 Distributed Lags and Wide-Sense Stationary Processes	871
32.1 A Characterization of Wide-Sense Stationary Processes	872
32.2 Linear Least-Squares Prediction	884
32.3 Distributed Lags and Optimal Stochastic Control	899
33 Trends, Cycles, and Seasonals in Economic Time Series and Stochastic Difference Equations	914
33.1 Modeling Trends, Cycles, and Seasonals in Economic Time Series	914
33.2 ARIMA Processes	921
33.3 Dynamic Stochastic Processes	933
33.4 Concluding Remarks on Multivariate Dynamic Stochastic Processes	940
34 Least Squares and Stochastic Difference Equations	946
34.1 The Elimination of Trend, Cycle, and Seasonal Factors in Time Series	947
34.2 Estimating the Coefficients in a Stochastic Difference Equation: Consistency	962
34.3 Estimating the Coefficients in a Stochastic Difference Equation: Limiting Distributions	974
34.4 Concluding Remarks	983
Notes	987
Bibliography	996
Index	1015