Microeconomics–2

Lecturer: Alla A. Friedman  
Class teacher: Alla A. Friedman

Course description

Microeconomics-2 is a two-semester course for third year students divided into two parts. The first part covers all topics of the syllabus and the second part is devoted to supporting lectures. In the course of Microeconomics-3 students are expected to deepen their understanding of basic concepts, add further tools of analysis and develop their skills in applying theory to economic problems. The course pays special attention to problems of uncertainty, inter-temporal choice, general equilibrium and efficiency, asymmetric information and public choice.

The assessment of the students will be by the University of London (UL) examinations at the end of the sixth semester. During the sixth semester students are specially prepared to the University of London examination in the course of supporting classes.

Intermediate Microeconomics is a core discipline under world standards. It forms the basis of further economic studies in applied disciplines such as: courses in industrial organisation, public finance, labour economics, international economics, corporate finance, development economics, etc. The course is taught in English. The students are also studying for Russian degree in Economics, and knowing Russian terminology through reading in Russian is also required.

Prerequisites

Students are supposed to be competent in basic economic analysis up to the level of the Introductory Microeconomics and in calculus taught in the first year of studies. Students are also expected to be familiar with constrained maximisation/minimisation problems studied in the course of Mathematics for Economists during the second year of study.

The course itself provides a basis (and so serve as a prerequisite) for such courses as Industrial Economics, Public Sector Economics, International Trade, Labour Economics.

Teaching objectives

The objectives of the course are:

• to expand the students’ knowledge in the field of microeconomics and to make them ready to analyze real economic situations;
• to provide students with the knowledge of basic microeconomic models’ assumptions, internal logic and predictions, grounding the explanations on intuitive, graphical and analytical approaches;

• to develop the students’ ability to apply the knowledge acquired to the analysis of specific economic cases, recognising the proper framework of analysis and constructing the adequate economic models within this framework.

By the end of the course students are expected to have necessary skills for writing essays and reading economic literature.

Assessment

Control takes the following forms:

• written home assignments (10);

• essay (2000 words);

• midterm exam in the middle of fall semester (120 min.),

• mock exam (180 min) in the University of London examination format in the middle of the spring semester;

• written exam (120 min) at the end of the fall semester,

• University of London exam by the end of the spring semester (180 min).

Grade determination

The Fall semester will be determined from the following activities:

• home assignments (15%);

• Fall semester midterm exam (20%);

• essay (5%);

• fall exam (60%).

Course grade is determined by

• University of London exam grade (50%)

• Fall term grade (35%),

• Mock exam grade (15%).
Main reading


Additional reading


Articles

On consumer theory:


On the theory of firm:


Choice under uncertainty:


Market structures:


Market failures:


Internet resources and databases

- University of London Exam papers and Examiners reports for the last three years:
  http://www.londonexternal.ac.uk/current_students/programme_resources/lse/index.shtml

- Current course materials are post at the ICEF information system:
  http://mief.hse.ru

- Teaching materials for the LSE course Microeconomics EC202:
  http://darp.lse.ac.uk/Frankweb/courses/EC202/default.htm

- Students’ resources to accompany Pindyck R.S. and Rubinfeld D.L., Microeconomics, 7th edition, Pearson Higher Education, 2009:
  http://wps.prenhall.com/bp_pindyck_micro_7/


Course outline

Individual choice under certainty and uncertainty

1. Consumer Behaviour Under Certainty
   (KR Chs.2–5; V Chs.2–9,14; EE& A Chs.2–4; PR Chs.3,4; L&E Chs.2–5)

2. Choice Under Uncertainty
   Contingent commodities model. States of nature, concept of contingent commodities, budget constraint with contingent commodities (slope and position). Probability of a given state of the world, expected value and fair odds line. Attitude to risk and preferences over contingent commodities. Certainty
line and marginal rate of substitution along the certainty line. Graphical representation of the model. Example: optimal bet in a flipping-coin game (case of fair and unfair game). Application of the model: demand for insurance (fair and unfair insurance).


(KR. Ch.6; EE&A. Ch.17; PR. Ch.5; L&E Ch.8)

3. The Firm


(KR Chs. 7–9; EE&A Chs. 6–7; PR Chs. 6, 7; L&E Chs. 10–12, 24)

Partial equilibrium

4. Competition and Monopoly

Perfect competition when firms have identical costs: constant cost, increasing cost and decreasing cost industries. Perfect competition when firms have different costs. Benefits of exchange in a competitive market and the effects of government policies: total surplus and deadweight losses.

Inefficiency of pure monopoly: dead weight losses and losses from rent seeking activity. Different types of monopoly power and regulatory responses: government franchise monopoly, resource-based monopoly, patent monopoly, natural monopoly and monopoly by good management. Average cost pricing, rate of return regulation. Efficient regulatory solutions: regulation based on information about marginal cost and demand (per unit subsidy) and regulation, based on information about market demand only (subsidy, equal to consumer surplus).


(EE&A Chs. 8–10; 14, PR Chs. 8–11; KR Chs. 10–11, 23–24; L&E Chs. 13–16)
5. Strategic Behavior and Oligopoly


Entry, market structure and Strategic Entry Deterrence. Credible threat, strategic pre-commitment and monopoly by good management.

Product differentiation. Chamberlin models (small-number case and large-number case). Problem of optimality of the product variety in monopolistically competitive industry. Address models: Hotelling location model and the idea of the circle city model.

(EE&A Chs. 15–16; PR Chs. 12–13; KR Ch. 14–16; L&E Chs. 17–19)

6. Factor Markets

Relationship between firm’s and aggregate demand for factor of production. The elasticity of demand for product and elasticity of demand for a factor. Short-run and long-run elasticity of demand for a factor. Absence of Giffen factor. Elasticity of demand for a factor and elasticity of supply of other factors. The supply of factors and equilibrium in a competitive factor market: economic rent, transfer earnings and quasi-rent. Monopsony and monopoly in factor markets.

(EE&A Ch. 11; PR Ch. 14; KR Chs. 10–11, 14; L&E Chs. 21–25)

7. Saving, Investment and Allocation over Time

Intertemporal consumption and production: current and future consumption, rate of time preference.

Investment decisions and the present value rule. Separation theorem.

Renewable and non-renewable resources: equilibrium extraction paths.

Determinants of interest rate: default risk, risk variability; nondiversifiable (systematic) and diversifiable (nonsystematic) risk.

(EE&A Ch. 5; PR Ch. 15; KR Ch. 5; L&E Chs. 6–7)

General equilibrium, efficiency and market failures

8. General Equilibrium and Welfare Economics

General equilibrium under uncertainty: Arrow Debreu equilibrium in a model with contingent commodities.

Equity and distribution: utility possibility curve, social welfare function (additive function and maximin criterion). Redistributionist principle and productivity principle.

(EE&A Chs.12–13; PR Ch.16; KR Ch.12; L&E Chs.27–32)

9. 1. Asymmetric Information: Basic Ideas

Classification of the models: situation with hidden characteristics and situation of hidden action.


(EE&A Ch. 20; PR Ch. 17; KR Ch. 17; L&E Chs. 8, 26)

10. Externalities and Public Goods


(EE&A Ch. 18; PR Ch. 18; K&R Ch. 18; L&E Ch. 31)

11. Government and Public Choice


(L&E Chs. 33–35)

Distribution of hours
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