Intermediate Microeconomics (second year, 2012-13)

Course Description

Lecturers: *Yuriy Avtonomov and Roman Chuhay*
Classteachers: *Yuriy Avtonomov, Roman Chuhay, Evgeniy Andreev, Irina Semenova, N. Lopatin*

Course description

Microeconomics is a one-semester course for the second-year students taught in the third semester. The assessment of the students will be by the University of London (UOL) examinations at the end of the fourth semester. During the fourth semester students are specially prepared for the University of London examination in the course of supporting classes. Students are supposed to be competent in basic economic analysis up to the level of the Introductory Microeconomics taught in the first year of studies. Intermediate Microeconomics is a core discipline, which forms the basis for further economic studies in applied disciplines such as: courses in industrial organization, public finance, labour economics, international economics, corporate finance, development economics, etc. The course is taught in English.

Teaching objectives

The objectives of the course are:

- to expand the students' knowledge in the field of microeconomics and to train them to analyze real economic situations;
- to provide students with the knowledge of basic microeconomic modeling assumptions, internal logic and predictions, grounding the explanations mostly on intuitive and graphical approaches, adding some simple algebra;
- to develop the students' ability to apply the knowledge acquired to the analysis of specific economic cases, recognizing the proper framework of analysis and constructing the adequate economic models within this framework.

Teaching methods

While teaching the course the following teaching methods, forms of study and control are used:

- lectures;
- classes;
- written home assignments, regularly checked and marked by the class teacher and discussed in detail in class;
- essays writing in one of the course topics;

- teacher's consultations;
- self-study;
- intermediate control: one examination paper in the middle of the third semester and a Mock exam in the University of London examination format not long before the end of the fourth semester;
- final control: an examination paper in the University of London examination format following the third semester and the University of London examination.

Self-study is a very important component of success in the course.

Grade determination

The students should take the interim written exam in the middle and the final written exam – in the end of the third semester. Each of the exams is in the University of London format, that is, includes choice among free response questions.

The grade given after the end of the third semester is determined according to the following scheme: the Final exam gives 60% of the grade, the interim exam weighs 30% and home assignments - 10% of the grade.

Final grading under the Higher School of Economics degrees takes place after the University of London written exam, according to the following scheme: the University of London exam accounts for 50%, the third semester grade – for 30%, April Mock exam and home assignments written in the fourth semester – for the remaining 20% of the final grade. The April Mock exam is held and marked by Russian professors in the UOL exam format.

Textbooks

1. Amos Witztum, Economics. An Analytical Introduction. - Oxford University Press, 2005. [AW]
2. Amos Witztum, Introduction to Economics. - University of London, 2005, reprinted 2011 (study guide), [AWSG]
3. Чеканский А.Н., Фролова Н.Л. Микроэкономика. Промежуточный уровень (учебник), ИНФРА_М, 2005 [Ч & Ф].
4. Чеканский А.Н., Фролова Н.Л. Микроэкономика. Промежуточный уровень (учебное пособие), ИНФРА–М, 2005 [Ч & Ф - уп.].
5. Hal R.Varian. Microeconomics. Fourth or fifth edition. W.W. Norton and Company, 1996, 2000. [HV]
6. Saul Estrin, David Laidler, Michael Dietrich, MicroEconomics. - Financial Times / Prentice Hall; fifth edition edition, 2008 [E & L]

Course Outline

1 Demand and consumer choice theory

1.1 Essential assumptions about preferences. Indifference curves and MRS. (2h)

General consumer choice framework: stable preferences, varying constraints, certainty and individual rationality. Axioms of completeness, transitivity, reflexivity and non-satiation, and their implications for the indifference curves map. Marginal rate of substitution: definition and interpretations. Further properties of a standard indifference curves map: strict convexity (diminishing MRS) assumption.

Reading: *AW pp. 35-54, HV ch. 2-3, E & L, ch. 2*

1.2 Linking preferences and utility. Utility maximization problem. (2h)

Comparing the cardinal and ordinal approaches to the preferences analysis. Definition and properties of a utility function. Homothetic preferences. Budget constraint: graphical presentation and algebraic description under monetary income, income in kind, and "mixed" cases. Utility maximization problem: graphical interpretation and the characteristics of an interior solution.

Reading: *AW pp. 55-58, HV ch. 4-5, E & L, ch. 2, Ч & Ф - yn., sections 1.3 and 1.4.*

1.3 Solution of the utility maximization problem (UMP). Comparative statics of individual demand. (2h)

Solution of the UMP: individual demand functions. Homogeneity of degree zero in prices and income. Comparative statics of the solution to UMP. Reaction to price change: demand and "price-consumption" curves. Reaction to income change: "income-consumption" and Engel curves. Substitution and income effects: Hicks and Slutsky definitions of real income. Market demand.

Reading: *AW ch. 2, pp. 68-71, HV ch. 6, 8, 15, E & L, ch. 2, 3, Ч & Ф - ., sections 2.3 and 2.4.*

1.4 Demand elasticities: typology of economic goods. Interrelations between elasticities in a two-goods world. (2h)

Own-price elasticity of demand: ordinary and Giffen goods. The relation between price elasticity of demand for a good and total expenditure on this good. Cross-price elasticity of demand: gross substitutes and complements. Asymmetry of cross price elasticities. Income elasticity of demand: inferior, normal, necessity and luxury goods. Interrelations between elasticities in a two-goods world: income elasticities, own and cross-price elasticities, income and own-price elasticities.

Reading: *AW pp. 64-68, 71-75, HV ch. 6, 15, Ч & Ф - yn., sections 6.3, 7.3 (except those involving compensated demand or expenditure function).*

2 Production and costs, behaviour of a firm and market supply

2.1 Representing technologies: production function and its properties (2h)

Production function and factors of production. Concepts of short- and long-run. Technically efficient combinations and isoquant map. Diminishing marginal productivity of inputs, relations between marginal and average input productivities. Marginal rate of technical substitution. Concept of homogeneity and its relationship with returns to scale.

Reading: *AW pp. 102-120, HV ch. 17, E & L, ch. 11, Ч & Ф - yn., sections 8.3 and 8.4.*

2.2 Cost minimization problem (CMP) and its solutions. (2h)

The CMP and the cost minimizing input mix in the short-run and in the long-run. The short- and long-run comparative statics of the solution to CMP: expansion path. Interrelations between short-run marginal costs and marginal product of labour, short-run average costs and average product of labour; short-run marginal costs and short-run average costs. Interrelations between short-run and long-run costs. Returns to scale and the shape of long-run total and average cost curves.

Reading: *AW pp. 120-131, HV ch. 19, 20, E & L, ch. 12, Ч & Ф - yn., sections 9.3 and 9.4.*

2.3 Profit-maximizing behavior of a price-taking firm (2h)

The price-taking firm's profit maximization problem (PMP). Solution to the PMP: the individual supply function. Short-run profit-maximizing choice of a competitive firm and its short-run supply curve. Long-run supply curve of a competitive firm.

Reading: *AW pp. 131-144, HV ch. 21, Ч & Ф - yn., sections 10.3 and 10.4.*

3 Market Structures

3.1 Market Supply of Competitive Firm and Industry (2h.)

Short-run supply of a firm and industry. Short-run equilibrium of a competitive industry. Changes in factor prices in the short-run. Long-run supply of a firm. Long-run supply of industry in the presence of CRS, IRS, DRS. Comparative statics in the long-run. Supply elasticity.

Reading: *AW pp. 160-167; Ч & Ф - yn., pp. 247-260; HV, ch. 22*

3.2 Competitive Market: Government Interventions (2h.)

Taxes in the short-run. Division of tax burden. Taxes in the long-run. Deadweight losses of taxation. Subsidies. Import tariffs. Efficiency.

Reading: *AW pp. 190-206; Ч & Ф - yn., pp. 281-291; HV, ch. 23*

3.3 Monopolistic Markets (4h.)

Monopoly as a market structure. Prerequisites of monopoly appearance. Types of barriers to entry. Monopolist problem. The relationship between marginal revenue and elasticity. Monopoly power and its measurement. Monopolist choice in the short-run. The monopolist choice in the long-run. Social costs of a monopoly. Regulations of monopolistic market: maximal price cap, subsidy. Price discrimination of 1st, 2nd and 3rd orders. The concept of natural monopoly and subadditivity of costs. Dilemma of natural monopoly regulation. Monopolistic competition: setup of the model, main assumptions. The impact of lump-sum and per unit taxes and subsidies on the choice of a firm in a monopolistic competition industry. Definition of Lerner index and its derivation. Classification of oligopoly models. Assumptions of the Cournot model. Nash equilibrium. Definition of the best response function and its derivation for the case of two firms. Equilibrium in the Cournot model.

Reading: *AW pp. 167-190, 207-221; Ч & Ф - yn., pp. 294-304, 306-317, 326-357, 368-376; HV, pp. 415-455, 477-480*

4 Market for Factors

4.1 Factor demand (1h)

Optimal inputs mix and expansion path. Substitution and output effects of a factor price change. Industry demand for a factor in the short and in the long run. The industry demand for labour: "real wage" and marginal revenue product approaches.

4.2 Factor supply (1h)

Individual labor supply curve derivation. Graphical derivation of the backward-bending individual labour supply curve. The impact of wage and income taxes on individual labor supply curve. Competitive market labour supply. Equilibrium in the labour market: the problem of stability, the impact of taxation and wage controls.

Reading: *AW pp. 225-253; Ч & Ф - yn., pp. 516-527.*

5 General Equilibrium and Efficiency

5.1 General Equilibrium (2h)

Interdependence of demand functions. The concept of general competitive equilibrium. Excess demand function. Derivation of partial equilibrium. Equilibrium in two markets. Warlas' law. General equilibrium conditions. Pareto optimality and efficiency.

Reading: *AW pp. 254-275; Ч & Ф - yn., pp. 547-559, 562-565; HV, pp. 534-549*

5.2 Edgeworth-box Economy (2h)

Setup of the Edgeworth-box economy framework. Efficient allocation. Contract curve. General equilibrium in production. Efficient allocation of production factors. First and second welfare theorems.

Reading: *AW pp. 275-288; Ч & Ф - yn., pp. 566-578; HV, pp. 507-515, 525-531*

6 Externalities and Public Goods (2h)

6.1 Externalities (1h)

The concept of externalities. Externalities in production and consumption. Inefficiency caused by: negative production externalities, positive production externalities. Regulations: Pigovian tax. Coarse theorem.

Reading: *AW pp. 301-311; Ч & Ф - yn., pp. 613-622, 625-636; HV, ch. 569-588*

6.2 Public goods (1h)

The concept of a public good and its main features. Non-rivalness and non-excludability. Free rider problem. The optimal provision of public goods.

Reading: *AW pp. 311-317; Ч & Ф - yn., pp. 640-650; HV, pp. 617-622*