

# Public Policy Course Number 324

## Microeconomics II

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Harris Graduate School of Public Policy Studies  
University of Chicago

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### Course Overview and Outline

#### -3. Course Content

- A. This course is the second in the Harris School's two-course sequence in Microeconomics. All students entering the class should have taken Public Policy 323 or its equivalent.
- B. In this second course we will explore why markets (policies) might fail to be efficient and what policies (markets) may be used to correct these inefficiencies. Using the competitive model developed in the first course as a point of departure, we will examine how different market structures, the existence of externalities, and informational considerations alter the performance of the market. We will also examine the welfare implications of using markets to allocate resources.
- C. The course will utilize calculus as a tool in helping to explain the numerous models we will develop.
- D. This course is fundamentally about the tools of economics and the economic approach to analyzing behavioral and policy issues. Your responsibility in the course is to come to understand these tools and to be able to use this approach in your policy analyses; to develop the ability to critically think like an economist.

#### -2. Textbook and Readings

- A. There is no required textbook for the class. However, you might want to obtain a used copy of Hal R. Varian, *Intermediate Microeconomics: A Modern Approach*, New York: W.W. Norton and Company.
- B. There are other excellent texts available concerning the subject of microeconomics. The teaching assistants and I will be glad to make a recommendation to you regarding using a secondary text. Feel free to ask us which text would be a wise selection for your needs.

#### -1. Exams, Problem Sets, and Grading

- A. There will be three problem sets during the quarter as well as an in-class midterm and a final examination during finals week. Relevant dates for these assignments are delineated in the course outline which follow.
- B. The midterm examination will only cover material presented up until that time in class.
- C. The final will cover the material for the whole course.

- D. Your course grade will be based upon your performance on the two exams and the problem sets. The midterm examination will count for 30 percent of your grade; the final examination will count for 50 percent of your grade; and the problem sets will account for 20 percent of your grade.
- E. No early or make-up examinations will be offered. In the case of extreme circumstances, students must obtain a written statement from the Dean of Students to be excused from an examination. In these circumstances, the student's grade will be determined by the grades on the other exam and problem sets.
- F. The teaching assistants for the course will conduct review sessions weekly. At these sessions, the teaching assistants will clarify concepts from the lectures and reading and review material from the problem sets and midterm examination. Each teaching assistant will also have weekly office hours.
- G. Grading of all problem sets and examinations will be conducted by the Professor.
- H. What follows is the formal outline of the course.

# **COURSE OF STUDIES**

## **0. The Heart of Microeconomics: Exchange and the Competitive Market**

**Themes:** How can economists get away with notions of “invisible hands” and other such magic tricks? Why are market institutions and their associated rules important? What does it mean to assume that people behave “as if” they are maximizers or optimizers? What really happens in a market?

- A. Three Recurring Themes: Choice, Competition, and Cooperation
- B. Maximizing Behavior and Individual Choice
- C. Cooperation in a Prisoners’ Dilemma Environment
- D. Competition in a Double Oral Auction

*(One lecture)*

## **1. Government Intervention in the Marketplace**

**Themes:** How can the government intervene in the operations of a competitive environment? What are the tools of command and control policy? What unforeseen consequences do the use of these policies produce? What happens to the economic system when one market is disturbed? What are the political realities of government intervention in the market? Why do Americans love devices and injunctions so much over user fees and taxes in so many situations?

- A. Market Equilibrium
- B. Price Controls in a Competitive Market
- C. Tax Structures and Their Impact on the Competitive Market
- D. Injunctions and Quota in a Competitive Market

*(three lectures)*

## **2. Alternative Market Structures and Regulation**

**Themes:** How do economists define the different market structures they study and how does this relate to markets in an applied setting? How is monopoly power determined? Are we all monopolies of some sort and, if so, what does that mean? Why do we sometimes discriminate and at other time find the discrimination process repugnant? What are the salient features of oligopoly behavior that are so challenging to model? How does mathematical game theory (through primarily Prisoners’ Dilemma structures) contribute to our study of oligopoly?

- A. A Taxonomy of Market Structure; Sources of Monopoly Power
- B. Monopoly Pricing Behavior and Regulation
- C. Measuring the Power of a Monopoly
- D. A Short Introduction to Antitrust Legislation: Practical Measurement Issues
  - E. Price Discrimination
  - F. Oligopoly Behavior
  - G. Game Theory and Market Structures

*(five lectures)*

### **3. Public Goods, Externalities, Spillovers, and NIMBY Problems**

**How are public goods produced, provided, and financed? How do we measure this process? What tools are used to measure the value of a public good and how accurate are they? How do we handle the tough cases where public goods are not traded in markets and have esoteric values? How do people scientifically and psychologically respond to risk in their environment? What are the special problems associated with siting an externality?**

- A. A Taxonomy of Extra-Market Phenomena
- B. Feedback Loops and Externalities:  
        The Economics of the Senses
- C. A Taxonomy of Non-Use Values for Public Goods: From Use Value, through Option Value, to Pure Existence Values
- D. Public Goods: Production, Provision, and Financing Considerations
  - E. Externalities and Spillovers
  - F. The Pragmatic Problems Associated with Correcting Externalities
    - G. An Aside: Choice in Risky Situations
    - H. Cognitive Psychology, Risk, and Externalities
      - I. NIMBY Type Externalities

*(five lectures)*

## 4. Asymmetric Information and the Behavior of Markets

**Theme:** What happens in a market where information of importance is known to a minority of the agents? When individuals can take hidden actions? What remedies can be used to correct these situations and to promote efficiency?

- A. The Market for Lemons
- B. Adverse Selection
- C. Moral Hazard

*(one lecture)*

## 5. Welfare Economics and Exchange

**Theme:** How do we integrate multiple markets and determine system and systematic behaviors in the economy? What theoretical underpinnings allow us to make such an integration? How are such models used in practical applications?

- A. The Edgeworth Box and Pareto Efficiency
- B. Social Welfare Functions
- C. Fairness, Equity, and Envy: Practical Applications
- D. Practical Problems Associated with General Equilibrium
- E. Building, Using, and Interpreting General Equilibrium Models of an Economy

*(two lectures)*

## 6. The Meaning of It All: Lasting Microeconomic Impressions

**Theme:** Inside of the textbook, outside of the textbook, and practical, applied economics in the field. The limits to economic reasoning. Things that are always true in economics. A pathway to future thinking about applied economics and policy.

A. The Scientific and Artistic Challenge:  
Creating Economic Analysis High in Chroma

1. Respect for the diversity of skills necessary to conduct public policy analysis.
2. A high level of comfort with uneasiness, imperfection, under-identified systems and results, and criticism.
3. Willingness to apply statistical techniques where theory does not provide a closed solution.
4. An appreciation of research as a scarce resource in improving our understanding of public policy.

**B. THE DISTILLATE OF ECONOMICS:  
THINGS THAT ARE ALWAYS TRUE IN ECONOMICS**

1. "Never underestimate the other guy's greed." (Frank Lopez in *Scarface*, 1983) Never underestimate how a person's animal spirits will lead them to compete in the marketplace.
2. When people have more resources, they are almost always better off ...
3. But since resources are limited, when people devote resources to one area, they have less to devote to other areas.
4. When the price of something changes, it attracts peoples' attention.
5. Institutions, and the rules under which they operate, matter.
6. Understanding all of the factors that explain human behavior is a complicated business
- 7.
8. But, in applied economics, the three central concepts of choice, competition, and cooperation generate the most grasping insights.

***(one lecture)***