

**Title:** ECON2110 (00002) Intermediate Microeconomics  
2009 - 2010

**Lecturer:** Prof. Tsang Shu-ki (Room WLB 529)

**Prerequisite:** ECON 1110 Principles of Microeconomics

**Objective:** This subject aims at providing students with more knowledge of economic theories which are relevant for the analysis of both market economies and centrally planned economies, as well as economic systems which are in the process of transition. After discussing the major analytical approaches to the investigation of different microeconomic phenomena, efficiency and welfare issues concerning the capitalist and the socialist systems will be covered, leading to a study of microeconomic reform options. A certain amount of mathematics ranging from calculus to game theory is to be used, but will first be reviewed or introduced. Students will then be familiarised with them through exercises.

**Texts:**

*Varian, H.R., Intermediate Microeconomics: A Modern Approach, 7<sup>th</sup> edition, W.W. Norton, 2006.*

*Roland, Gérald, Transition and Economics: Politics, Markets and Firms, MIT Press, 2000.*

**Major References:**

\*Benassy, J.P., Economics of Market Disequilibrium, Academic Press, 1982.

\*\*Bennett, J., The Economic Theory of Central Planning, Basil Blackwell, 1989.

\*Boadway, R., Welfare Economics, Blackwell, 1984.

\*\*Buck, T., Comparative Industrial Systems: Industry under Capitalism, Centrally Planned Economies and Self Management, Macmillan, 1982.

\*Davis, C. and Charemza, W.W., Models of Disequilibrium and Shortage in Centrally Planned Economies, Chapman and Hall, 1989.

\*Dixit, Avinash and Skeath, Susan, Games of strategy, 2<sup>nd</sup> edition, W.W. Norton, 2004.

\*Hirshleifer, J., Price Theory and Applications, 5<sup>th</sup> ed., Prentice Hall, 1992.

\*Kornai, J., Economics of Shortage, Vol.I & II, North-Holland, 1980.

\*Mishan, E.J., An Introduction to Political Economy, Hutchinson, 1982.

\*Mishan, E.J., The Costs of Economic Growth, revised edition, London: Weidendeld and Nicolson (distributed by Oxford University Press), 1993.

\*Shughart II, William F. and Razzolini, Laura (editors), The Elgar Companion to Public Choice, Edward Elgar, 2001.

\*Starrett, David A., Foundations of Public Economics, Cambridge University Press, 1988.

\*\*\*Thomas, L.C., Games, Theory and Applications, New York: Halsted Press, 1984.

\*Tollison, Robert D. and Congleton, Roger D. (editors), The Economic Analysis of Rent Seeking, Edward Elgar, 1995.

\*Thompson Jr., A.A., Economics of the Firm: Theory and Practice, 5<sup>th</sup> ed., Prentice Hall, 1993.

\*Tsang Shu-ki, "Against 'Big Bang' in Economic Transition: Normative and Positive Arguments", Cambridge Journal of Economics, Volume 20, Number 2, March 1996, pp.183-193.

\*Tsang Shu-ki and Cheng Yuk-shing, "Plan Evasion and Supply Instability in a Double-track System", Economics of Planning, Volume 30, Number 1, 1997, pp.1-16.

\*\*van den Doel, H., Democracy and Welfare Economics, Cambridge University Press, 2<sup>nd</sup> edition, 1993.

\*\*\*潘振民、羅首初，《社會主義微觀經濟均衡論》，上海三聯書店，一九八八年。

\*/\*\*/\*\* References which are likely to be used more often than others.

<b>Assessment:</b> Class Participation and Discussion	10%
Assignments/exercises	10%
Test	30%
Examination	50%

### Subject Content:

- I. Different Behavioural Patterns and Analytical Models on Equilibrium, Disequilibrium and Shortage
  - A. Equilibrium Approach: **optimal** and **efficient equilibrium**
    - i. What is “equilibrium”---the “benchmark” and/or end-state of economics?
    - ii. Is an equilibrium necessarily “desirable” (“best”)? Different concepts of equilibrium, optimum and efficiency
    - iii. Consumer theory: maximising utility to achieve an optimum
    - iv. Production theory: maximising profit/output or minimising cost
    - v. Distribution theory: how to reward factors of production?
  - B. Disequilibrium Approach: **suboptimal** and **inefficient equilibrium**
    - i. an equilibrium may not be optimal (or the “best”)!
    - ii. short-run and long-run equilibrium: dynamic specifications based on partial adjustments and adaptive expectations
    - iii. quantity rationing, market non-clearing and disequilibrium
    - iv. rationing, price controls and virtual/shadow prices
  - C. Economics of **Shortage**: chronic excess demand/insufficient supply (in socialist economies)
    - i. shortage compared with disequilibrium
    - ii. different causes of shortage
    - iii. the importance of soft budget constraint

Key references: Varian; Davis and Charemza; Benassy; Kornai; Roland.

II. Welfare Economics: why is **some allocation/distribution** regarded as “good” or **“optimal”** in economics?

A. Strategic Interdependence and Game Theory

- i. going **beyond individual optimisation**: the importance of **strategic interdependence** in economic activities
- ii. the game-theoretic approach and **Nash equilibrium**: the differences with the approaches introduced in Section I
- iii. solving various **two-person games**: zero-sum, variable-sum, non-cooperative, and cooperative games
- iv. applications
- v. asymmetric information: principal-agent theory

B. The Basics of Welfare Economics

- i. the meanings of welfare in economics
- ii. individual welfare and social welfare
- iii. dealing with conflicts: **the Pareto criterion**
- iv. the problems about the Pareto criterion

C. Market Failure and Disequilibrium

- i. cases of **market failure** and **Pareto suboptimality**
- ii. various proposals of remedy and rectification
- iii. a closer look at the **Coase Theorem** and privatisation
- iv. **democracy** as a mode of economic decision making?

Key references: Thomas; Dixit and Skeath; Boadway; Varian; Mishan; van den Doel; Shughart II and Razzolini.

III. Comparative Industrial Systems and Reform Microeconomics

A. Comparative Industrial Systems

- i. capitalist system
- ii. centrally planned system

- B. Reform Microeconomics for Centrally Planned Economies
- i. different proposals to harden the budget of, to provide incentives for, and to monitor the performance of enterprises: **optimal contract?**
  - ii. the **double-track system** in microeconomic transition: rationale and difficulties
  - iii. drastic privatisation versus “parallelism”: efficiency, equity and other constraints
  - iv. whither reform: **“big bang”, gradualism and the problems of optimal sequencing**

Key references: Buck; Bennett; 潘振民、羅首初; Roland; Tollison and Congleton; Tsang; Tsang and Cheng.