Paper 1: Economics I & II

An introduction to economic concepts and theory and to the economic environment in which the private sector, governments and public organisations operate.

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Aims
Economics (Papers 1A and 1B) is an introductory course aimed specifically at students of Land Economy. It aims to give students a rigorous foundation in economics as well as the intellectual tools to take the applied economics courses in Parts IB and II of the Land Economy Tripos. The course is designed to accommodate those who have not studied economics before, but quickly proceeds to more challenging material.

General outline
The course is split into three distinct parts with each examining a major branch of economics. Paper 1A: In the Michaelmas term, the focus is on Microeconomics (14 lectures), in the Lent term it is on Welfare Economics (8 lectures). Paper 1B: In addition to Microeconomics and Welfare Economics, a course in introductory Macroeconomics will be taught during the Lent Term (14 lectures). Throughout the course supervisions are organised on a regular basis (usually once a fortnight) to enable students to examine particular aspects of the course in greater depth.

Learning outcomes
By the end of the course, students will be able to understand and apply the basic principles of Microeconomics, Welfare Economics and Macroeconomics. In Microeconomics, students are expected to identify clearly and apply the different theories of consumer behaviour, the firm and industrial organisation to real world problems. At the end of the course students will be able to demonstrate their understanding about issues such as the way in which prices affect consumers’ choices, the role of markets in coordinating decentralised behaviour, how firms respond to changing technologies and the causes and consequences of different forms of industrial organisation under competition, and various forms of monopolistic and oligopolistic behaviour. By the end of the Lent term students should also be able to demonstrate their understanding of the welfare properties of perfectly competitive markets, and their failure including the concepts of externalities, market failure and moral hazard and their associated social welfare implications. From the Macroeconomics component of the course, students will be familiar with basic theories relating to the working of the economy. Students will be able to apply different analytical tools and models to different timeframes of policy analysis: in particular, the short run, the medium run, the long run and consider the impacts international interactions. Students will also be able to apply these models to analyse major policy issues such as: what, if anything, can a government do to combat recessions?; what are the causes of inflation and how the Bank of England’s Monetary Policy Committee seeks to control it?; what are the causes of underdevelopment in Sub-Saharan Africa and other regions of the world characterised by mass poverty?
Course outline:

Michaelmas Term

Paper 1A: MICROECONOMICS (14 Lectures and 4 supervisions)
This section of the course comprises 14 lectures on important topics in Microeconomics with the emphasis on theory that underpins work in Applied Economics.

The principal textbook is:
This is an excellent textbook. While there are many good textbooks on the market, the lectures will be based on this book and you are encouraged to obtain a copy (earlier editions are also fine).

Useful supplementary textbooks are:
Perloff, J. (2003), Microeconomics, 3rd edition, Pearson Education. This is a good book and popular with some students.
Pindyck, R. S. and D. L. Rubinfeld (2005), Microeconomics, 6th edition, Prentice Hall.

Two good sources which include real life examples are those by:

Lectures

Theory of consumer behaviour

Lectures 1-2: Introduction to Microeconomics, the course, and the theory of choice
Introduction to the course and to the basic theory of choice and individual consumer behaviour.
Reading: Varian (chapters 1-4)

Lectures 3-4: Characterisation of consumption goods
Demand and Engel curves; normal versus inferior goods; ordinary versus Giffen goods; substitutes and complements; compensated and uncompensated demand curves; Slutsky and Hicksian substitution effects, and income and endowment effects.
Reading: Varian (chapters 5-9)

Lectures 5-6: Intertemporal choice and Introduction to the Theory of the Firm
Intertemporal Choice: Consumption, saving and the interest rate and Net Present Value
Reading: Varian (chapters 10-11)
Introduction to the theory of the firm: Production functions, technology, isoquants, returns to scale.
Reading: Varian (chapter 18)

Theory of the firm Continued

Lectures 7-8: Technology: The physical relationship between inputs and outputs
leading to the theory of the costs of production
The long run and short run cost curves; average and marginal cost curves, cost minimisation; economies of scale.
Reading: Varian (chapters 22-23)

Lectures 9-10: Profit maximisation and supply in perfect competition
Perfect competition, average and marginal revenue, long run and short run equilibrium, firm and industry supply.
Reading: Varian (chapters 19 and 22-23)

Industrial organisation
Lectures 11-12: Monopoly and natural monopoly  
Market power, production decisions, and different forms of price discrimination.  
Reading: Varian (chapters 24-25)

Lectures 13-14: Game Theory, monopolistic competition and oligopoly  
Product differentiation, Hotelling’s paradox, non-collusive oligopoly; quantity and price leadership.  
Reading: Varian (chapter 27)

Supervisions  
Four supervisions will be held during Michaelmas term on the following topics: (i) static consumer behaviour; (ii) intertemporal choice and discounting; (iii) the theory of the firm; (iv) industrial organization. Handouts with precise details of the supervision topics and further reading will be distributed during the term which are also accessible through the course web page.

Lent Term

Paper 1A: WELFARE ECONOMICS (8 lectures and 1 supervision)

This section of the course offers an introduction to normative or Welfare Economics and provides some examples of how the analysis can be used when markets fail. The subjects covered are not necessarily self-contained; therefore for this part of the course the reading list is general and not specific to each lecture. Students without A level economics may wish to start with H. Varian, *Intermediate Microeconomics: A Modern Approach*, but must then go on to the more advanced material.

Main textbook  

Advanced textbooks  

Lectures

Lecture 1: The Concept of Pareto Optimality  
Normative versus positive economics, allocative efficiency, equity, measuring welfare, Pareto criterion, Edgeworth box, consumer and producer equilibrium, the efficiency of competitive markets, First and Second Welfare Theorems.

Lectures 2-3: The Compensation Principle and the Old ‘New’ Welfare Economics  
New Welfare Economics, the compensation principle, social welfare function, Arrow’s impossibility theorem, equality, notions of fairness, Rawls’ difference principle, utilitarianism.

Lecture 4: The Case for State Intervention: (i) Monopolies  
Pareto efficiency and perfect competition, equity and efficiency issues, monopoly, consumer and producer surplus, natural monopoly, the benefits of entrepreneurial and big-firm capitalism.

Lecture 5: The Case for State Intervention: (ii) Externalities  
Negative and positive externalities, private and social costs and benefits, property rights, the free-rider problem, tradable carbon emission permits.
Lecture 6: The Case for State Intervention: (iii) Public Goods
Private and public goods, market failure, the optimal level of public expenditure, logrolling, median voter theorem, probabilistic voter theorem, bureaucratic solutions.

Lecture 7: Asymmetric Information and Market Failure
The market for lemons, insurance, credit, baseball, moral hazard, the Asian crisis, the US subprime crisis, principal/agent problems.

Lecture 8: Housing Policy and Slums
Quality of the housing stock, poverty, externality view of slum creation, prisoners’ dilemma, income transfers versus housing subsidies, rent control, the UK evidence.

Supervisions
The supervision will be held in the Lent term, but there will be an opportunity for students to submit additional supervision/past examination questions to the lecturer during the Easter vacation and Easter term. Topics covered: the First Welfare Theorem; market failure; tradable carbon permits and the optimum level of public expenditure.

Lent Term

Paper 1B: MACROECONOMICS (14 lectures and 4 supervisions)
The course provides a comprehensive and critical introduction to the key principles of modern Macroeconomics, presenting the subject as a series of models, each of which covers the functioning of a different aspect of the macro economy (and timeframes). By the end of the course and the attendant supervisions, students should be familiar not only with the (sometimes competing) models covered, but also be able to apply the models to analyse the effects of both policy and non-policy "shocks" to the macro economy. The course will take a primarily diagrammatic approach to the presentation of models, although some elementary algebra is essential. The course will also provide some discussion of the Great Recession.

The principal textbook is:

The lectures will be based primarily on this book and you are encouraged to obtain a copy (earlier editions can also be used).

Other useful textbooks are:

Lectures

Lectures 1 and 2: Introduction to Macroeconomics, the course, and the Keynesian-cross model
Introduction to the course, key macroeconomic concepts, the short-run, the goods market, and the Keynesian-cross model.
Reading: Blanchard and Johnson (chapters 1-3)

Lectures 3 and 4: The short run continued - equilibrium in the money and goods market: The IS-LM model
The goods market equilibrium, financial markets and the financial market equilibrium, the IS-LM model and the use and effectiveness of monetary and fiscal policy.
Reading: Blanchard and Johnson (chapters 3-5)
Lectures 5 and 6: The medium run - the Labour Market and the AS-AD Model
The labour market, the determinants of aggregate supply and aggregate demand, the AS-AD model and policy implications.
Reading: Blanchard and Johnson (chapters 6-7)

Lectures 7 and 8: The medium run continued – Unemployment and Inflation
Natural rate of unemployment, the Philips Curve and the effect of inflation on economic activity.
Reading: Blanchard and Johnson (chapters 8-9)

Lectures 9 and 10: The long run – growth models
The stylised facts of economic growth, and the Solow-Swan model and the role of savings and technological progress
Reading: Blanchard and Johnson (chapters 10-12). Supplementary reading: Jones and Vollrath (chapters 1-4)

Lectures 11 and 12: The Long-Run Continued – growth models continued and the role of institutions
Alternative growth models, the importance of institutions (norms, culture, and legal systems)
Reading: Blanchard and Johnson (chapter 13) and journal papers by by Acemoglu et al., and La Porta et al., on institutions - provided on Camtools). Supplementary reading: Jones and Vollrath (chapter 5)

Lectures 13 and 14: The Open Economy
The goods and financial markets in an open economy, the role of interest rates and exchange rates, the effectiveness of government policy in an open economy (including the Mundell-Fleming model and the Marshall Lerner condition).
Reading: Blanchard and Johnson (chapters 18-21)

Supervisions
Four supervisions will be held on the following topics: (i) the Keynesian-cross model; (ii) the IS-LM model; (iii) economic growth; and (iv) the Mundell-Fleming model.

Examination arrangements
The total course, Economics, will be examined through two separate two-hour written examinations: Paper 1A Microeconomics and Welfare (50% of the total marks) and Paper 1B Macroeconomics (50% of the total marks). Students will be required to answer three questions on each paper and all questions carry equal marks.