

AAE 635

Applied Microeconomic Theory

Fall 2011

12/12/2011

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Last class

- Efficiency (lecture note 11)
 - Decomposition of Lagrangean

Today and next




- Final Exam, Dec. 20th, 10-12pm, B30 Taylor
- Previous finals posted
- Homework #6 due
- Efficiency (lecture note 11)
 - Competitive equilibrium
 - Glitches (?)...
- Final review

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Competitive market allocations

- Assumptions so far...
 - Existence (A1) \rightarrow a; b; c;
 - Positive products (A2) } 
 - Non-satiation in \mathbf{g} for at least one household } 
 - $\mathbf{x}_i > 0$ for all households
 - Feasible set \mathbf{Y} convex (A3) } 
 - Quasi-concave utility function
 - Consumptions goods are private & no externality
- A4: non-joint production technology across firms
 - Well defined property rights
 - No externalities (positive or negative)

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Competitive equilibrium

- (Walrasian equilibrium)
 - Feasible allocation
 - M competitive firms max profits
 - N household min expenditure
 - Aggregate budget constraints satisfied (market clear)
- First welfare theorem
 - A competitive equilibrium is Pareto efficient
- Second welfare theorem
 - A Pareto efficient allocation can be sustainable by a competitive equilibrium
- “Invisible hand”
- Valid under what conditions?

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Gains from trade

- Pareto utility frontier vs. Autarky utility frontier
- Centralized vs. decentralized?

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Externalities

- Externality in production
- Externality in consumption
 - Public goods
- Centralized vs. decentralized?
- Possible solutions
 - Internalization
 - Market solution
 - Contract solution
 - Government solution: price vs. quantity

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Uncertainty

- Uncertainty vs. risks (vs. ambiguity)
- State-contingent decisions

- Ex ante or expected utility (or profits)

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Imperfect and asymmetric information

- “No information” vs. “Perfect information”
- Symmetric vs. Asymmetric
- “Good information” vs. “Poor information”
- Implications

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