MGP 202A: Markets and the Firm

Frank McCormick

Class meets: 6-9 PM, Monday (202A-1) or Thursday (202A-2)
Location: One Capitol Mall (OCM 1)
Prerequisite: Introductory course in economics
Office Hours: Monday and Thursday, 5-6 PM and 9-10 PM in the classroom
Email: fmccorm@astound.net
Class:
web site is at: http://my.ucdavis.edu
email archive: https://listproc.ucdavis.edu/class-secure/200501/mgp202a-w05
(Note: Both sections will use the same web site and email archive.)

Texts

Price Theory and Applications, sixth edition, by Steven E. Landsburg, Thomson - South-Western College Publishing (0-324-27448-3). This is a standard textbook for courses in microeconomics (price theory). It does not require a lot of mathematics, but it is very sophisticated economically. The answers to the homework problems will be posted on a password-protected part of the class web site. The user name is: mgp202a. And the password is: homework. (Please note that they are all lowercase.) If any of you would like to do additional practice problems on your own, I will place a Study Guide (by William V. Weber) for the text on two-hour reserve in the library (but this is not at all necessary).

The Economics of Public Issues, 13th edition, by Roger LeRoy Miller, Daniel K. Benjamin, and Douglass C. North; Addison Wesley (0-321-11873-1). This is a book of very interesting and even controversial (but not to economists) readings that demonstrate the power of economics. You will not be responsible for these readings on the exams. (But knowledge of these reading may help you better understand the material that will be on the exams.)

Course Description

In this course, we will analyze many microeconomic problems that are important to business. How do supply and demand interact to determine prices? How do prices transmit information and incentives from millions of consumers to millions of producers, and back? What steps can governments take to improve the
functioning of markets? What actions have governments taken that have made markets function worse?

Why did California experience an electricity shortage in 2001, while the rest of the country did not? What are the effects of minimum wage laws? What are the effects of rent controls?

How do taxes affect business? Why do taxes, tariffs, and subsidies usually reduce economic welfare? Should the entire Social Security tax be paid by employers? What is the rationale behind “supply side” tax cuts?

Why should consumers favor “predatory pricing?” Why did the European Commission kill the merger between General Electric and Honeywell, and why will this harm U.S. and European consumers? Why should consumers prefer (a) a Microsoft monopoly in both operating systems and browsers to (b) a Microsoft monopoly in operating systems and a Netscape monopoly in browsers?

Why should businesses not allow "sunk costs" to affect their decisions about the future? Why is "book value" a misleading indicator of a firm's value? Why can't "chartists" beat a stock-market index fund? Why can only a few equity mutual fund managers beat a stock-market index fund over the long run?

We will also analyze a few economic problems that are not necessarily important to business, but are simply fascinating. Why did the use of seat belts lead to an increase in deaths from auto accidents? Why did East German taxicab drivers go on strike to demand lower cab fares? Why is water (which is essential for life) much less expensive than diamonds (which are used mainly for decoration)?

We will analyze the recent business and accounting scandals, and we will discuss how corporate governance can be improved. Finally, I will suggest some simple retirement investment advice based mainly on the theory of efficient markets.

Course Organization

My goal in this course is for you to learn as much as possible about microeconomics as efficiently as possible. Toward that end, I will make considerable use of the Internet. If you are registered for the course, you should already be on the class email list. If for some reason you are not on the list, please get on it immediately. (If you want to redirect your email to another address, go to: http://computingaccounts.ucdavis.edu).

I will email the lecture notes to you a day or two before each lecture. Please check your email each day, especially on lecture days (in the very unlikely event I have to cancel class). All emails will be saved on the class email thread, so if
If you have any trouble understanding the reading material, do not hesitate to email your questions to me, and I will address them in the next lecture. Or if the question can be answered quickly, and is of interest to the whole class, I will forward my reply to the whole class (removing your name).

Participation in class discussions is strongly encouraged and will even be modestly rewarded. I suggest you bring the Landsburg text to class so you can write notes on the figures as I project them on the screen. I will invite your written suggestions for improving the class at the end of the second lecture and again after the mid-term, but you are welcome to email your comments to me at any time. (But please do not feel offended if I do not use your suggestion!)

In this course, learning economic theory will not be an end in itself, but rather will be a means to the end of understanding important economic problems. We will often use articles from The Economist, the Wall Street Journal, the New York Times, and BusinessWeek.

I will spend a great deal of time analyzing current economic problems because I believe students learn the principles of economics best when they can apply them to pressing economic issues. Also, this quarter I will invite students to test market a questionnaire for a research project aimed at increasing the number of transplant organs by offering financial incentives to donors. (Each year, about 7,000 people in this country die for lack of a transplant organ.)

Many of you know a great deal about particular markets or industries. Please share that knowledge with the class. Also, please send me articles that you think might interest the class. (But again please do not feel offended if I do not use them in the class!) I will take roll, but only to learn your names (not to see if you are present). So if you miss class, you do not have to inform me or provide an excuse. Feel free to tape record anything that I say in class.

**Code of Ethics Disclosure**

All students who take this course are governed by the University of California's standards of ethical conduct for students, in particular, the sections on academic conduct and integrity. These sections set forth the responsibilities of students
and faculty to maintain a spirit of academic honesty and integrity at U. C. Davis. It is essential that you are aware of this code of conduct and the disciplinary actions that may be taken in the event of a violation. Details may be obtained from the GSM Associate Dean or the Office of Judicial Affairs.

I assume all of you will rigorously abide by these ethical standards. This will allow me to be much more flexible with you if any of you have special problems. However, this only works if everyone is honest. If you think anyone is not abiding by these standards, please let me know.

Exams and Grading

In determining your course grade, the midterm will count one-third and the final two-thirds. The midterm will be on February 3 and 7. The final will be on March 17 and 21, and will cover just the material since the midterm.

All students are expected to take both the midterm and the final. I will not be able to offer make-up exams for the mid-term or the final. I expect the course grade distribution to be about average for core courses in the Graduate School of Management. Final letter grades will not be changed except for extremely good reason.

Exams will consist of a great many questions requiring relatively short answers. Exams will be relatively straightforward, and will emphasize understanding and reasoning rather than memorization of facts. Some of the exam questions will be similar to the homework and the examples given in the lecture notes. You will not be responsible for the many articles that I send you, or the readings in The Economics of Public Issues.

In preparing for the exams, I suggest you thoroughly understand the reasoning behind every sentence in the lecture notes. Put a question mark beside any statement that you do not understand, and ask me about it. Better yet, try to re-write the lecture notes in your own words. Also, try to study with other students if possible. This helps both those students who know a lot (because explaining things to others is a great way to learn) and those who do not. Grades will be available on SISWEB at the end of the quarter.

Subscriptions

If you are interested in foreign countries, I highly recommend The Economist. If you would like a trial subscription at reduced student rates, I will have a sign-up form available during the first week of class. I will also have a sign-up form for the Wall Street Journal. But neither is required for the course.
### Tentative Class Schedule

Classes will be held on the two holidays, 1/17 and 2/21. If you cannot make a Thursday class, you can just attend on the following Monday. And if you cannot make a Monday class, you can attend on the previous Thursday.

(Topics will be covered in this order, but not necessarily during the week indicated.)

(PT indicates *Price Theory*. EPI indicates *Economics of Public Issues*.)

<table>
<thead>
<tr>
<th>Week</th>
<th>Reading</th>
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| 1    | PT: Chapter 1: Supply, Demand, and Equilibrium  
      | PT: Chapter 4: Consumers in the Marketplace (Section 4.4 only)  
      | EPI: pp. 29-51 and pp. 60-64 |
| 2    | PT: Chapter 2: Prices, Cost, and Gains from Trade  
      | PT: Chapter 5: The Behavior of Firms  
      | EPI: pp. 1-28 |
| 3    | PT: Chapter 6: Production and Costs (Section 6.1 only)  
      | EPI: pp. 65-75 |
| 4    | PT: Chapter 7: Competition  
      | EPI: pp. 76-90 |
| 5    | Midterm Exam - February 3 and 7 |
| 6    | PT: Chapter 8: Welfare Economics and the Gains from Trade  
      | (Sections 8.1 and 8.3 only)  
      | EPI: pp. 91-105 |
| 7    | PT: Chapter 9: Knowledge and Information  
      | (pp. 291-97, 307-10, and 313-19 only)  
      | EPI: pp. 106-122  
      | Some Simple Retirement Investment Advice |
| 8    | PT: Chapter 10: Monopoly (pp. 329-47 only)  
      | EPI: pp. 123-140 |
| 9    | PT: Chapter 11: Market Power, Collusion, and Oligopoly  
      | (Section 11.1 only)  
      | EPI: pp. 141-151 |
| 10   | PT: Chapter 13: External Costs and Benefits |
(Section 13.1 only)
PT: Chapter 14: Common Property and Common Goods
(Section 14.1 only)
EPI: pp. 152-182

11 Final exam - March 17 and 21