

Microeconomics

“A cynic is a person who knows the price of everything and the value of nothing.”
Oscar Wilde

agents Microeconomics individual the the study behaviour of is of.

Its general concern is the efficient allocation of resources, between different uses.

profits involves determining the prices maximisation and of This utility or.

equilibrium price, quantity	prix, quantité d'équilibre
demand/supply function/curve	la fonction de la demande/de l'offre
a shift in the demand curve	un déplacement de la fonction de la demande

elasticity	élasticité
price elasticity of demand	élasticité de la demande par rapport au prix
unitary elasticity	élasticité constante
demand is infinitely elastic / inelastic	demande infiniment élastique / parfaitement rigide

In a perfectly competitive market, each firm faces a _____ demand curve (i.e. demand is _____ elastic.

slope, gradient	penne
perfect competition	concurrence parfaite
monopolistic competition	concurrence monopolistique
oligopoly	oligopole
monopoly	monopole
monopsony	monopsonne
price-maker	fixeur de prix
price-taker	preneur de prix

Complete the sentences using :

inelastic shift in gradient equilibrium supply

1. At the intersection of the demand and supply curve, the market is in _____ .
2. A technological breakthrough leads to a _____ the _____ curve.
3. When demand is completely _____ suppliers can raise prices without sales falling.
4. The lower the _____ the more elastic the demand curve is said to be.

Perfect competition assumes:

free knowledge sellers mobile homogeneous number a large

1. There are _____ number of buyers and _____ .
2. Products are the same, in other words they are _____ .
3. There is _____ entry and exit of firms into the market.
4. Factors of production are perfectly _____ .
5. Agents have perfect _____ of market conditions.

Theory of consumer behaviour	le calcul économique du consommateur
utility, utility function	utilité, fonction d'utilité
marginal utility	utilité marginale
utility maximisation	maximisation de l'utilité
indifference curve	courbe d'indifférence
indifference map	surface d'utilité
basket of goods	panier de biens
slope of the indifference curve = marginal rate of substitution	la pente de la courbe d'indifférence = taux marginal de substitution
perfect substitutes	biens de substitution
complementary goods	biens complémentaires
budget constraint (line)	contrainte budgétaire
price effect	effet de prix
substitution effect	effet de substitution
inferior good (Giffen good)	bien inférieur
Edgeworth Box	rectangle (ou boîte) d'Edgeworth
Pareto optimality	optimum Pareto
contract curve	courbe de contrat

Define a “normal (superior) good”:

1. Each indifference curve is convex to the _____ .
2. Rational economic agents are said to _____ utility given a fixed budget _____ .

An equilibrium is said to be Pareto _____ if it is impossible to improve the _____ of one agent (group of agents) without reducing the _____ of others.

Theory of Production	théorie de la production – calcul économique du producteur
production function	fonction de production
constant returns to scale	rendements d'échelle constants
diminishing returns to scale	rendements d'échelle décroissants
production possibility curve product transformation curve	frontière des possibilités de production
average cost (cuvre)	(courbe de) coût moyen
marginal cost (cuvre)	(courbe de) coût marginal
fixed costs	coûts fixes
variable costs	coûts variables
total costs	coût total

1. If output increases in a fixed proportion to the inputs used in production, it is said to have _____.
2. Plant and equipment are usually considered as _____ costs.
3. In a perfectly competitive market, _____ cost is equal to _____ cost, is equal to the market _____ of the good.
4. _____ competition occurs when there are many firms producing goods (or _____) that are close substitutes. Firms make products that _____ can differentiate. _____ for each firm's product(s) is not infinitely elastic, and consumers will have some preferences for particular suppliers. As a result, each firm has a slight _____ power.

Match the following words and their definitions:

perfect competition	This occurs in an industry in which there are many firms producing goods (or services) that are close substitutes. Firms make products that consumers can differentiate a little. Demand for each firm's product(s) is not infinitely elastic, and consumers will have some preferences for particular suppliers. As a result, each firm has a slight monopoly power.
monopolistic (imperfect) competition	There is a single buyer operating in the market, who is able to influence product price. Extra demand will be visible to the producers and will lead to a price rise.
oligopoly	The market is dominated by a single buyer and a single seller. The quantity and price of the product(s) sold will depend on the interaction between the two.
monopoly	There are a few large firms and products are often differentiated through advertising or other marketing techniques. The behaviour of firms is not explained by a single theory, as they may compete fiercely or collude. Frequently prices may be stable for long periods of time, which are separated by periods of strong price competition.
monopsony	There is only one supplier operating on the market, and the firm is not a price-taker. Output will be set so that marginal cost = marginal revenue
bilateral monopsony	Many small firms compete to supply a single product. Each firm faces a perfectly elastic demand curve and cannot influence the price of the product.

The strong assumptions underlying microeconomic analysis

Use the following words to complete the text below:

highest marginal assumed baskets available convex

In traditional microeconomic demand theory, consumers are _____ to be rational. Given a certain level of income, the consumer seeks to spend money in order to reach the _____ possible level of satisfaction or utility. This is the axiom of utility maximisation.

The consumer is assumed to have full knowledge of all the information needed to make his/her decisions, in other words the consumer is assumed to have complete knowledge of the products _____ and their prices.

It is also assumed that consumers can compare the utility to be obtained from different products or different “_____ of products” when making choices. So-called cardinal utility assumes that the consumer can actually measure the utility of a product (or basket of products), and some economists suggest that such utility can even be expressed in monetary terms. In this case, it is assumed the utility derived from successive units of a good will decline. This is the axiom of diminishing _____ utility. Money, which is used to express utility, is however assumed to have a constant marginal utility.

In contrast, to cardinal utility, ordinal utility merely assumes that the consumer can rank various baskets of goods. In this case, the marginal rate of substitution between baskets of goods is assumed to be diminishing, which means that indifference curves of utility are _____ to the origin.

Read the following text and answer the comprehension questions below:

Consumer behaviour must also be consistent and transitive. In other words, if in a particular period a consumer chooses one basket in preference to another, he/she will have the same preference in another period. Furthermore, if the consumer prefers basket A to basket B and also prefers basket B to basket C, then the consumer must prefer basket A to basket C.

Indifference curve analysis can be used to explain why individuals (or groups of individuals – regions, countries etc.) exchange commodities. Under certain circumstances such an exchange will lead to greater welfare for one individual without there being any reduction in the welfare of other individuals. In other words, exchange allows individuals to obtain a Pareto optimal distribution of commodities.

The theoretical device used to demonstrate the benefits of such exchange is the Edgeworth Box: which is drawn for two individuals and two commodities. Opposing corners of the Box are the origins of each individual’s indifference map: essentially an infinite number of convex utility indifference curves. By opposing the two indifference maps in the Box, it can be shown that a set of positions exists (the contract curve) on which each utility curve for one individual is tangential to the utility curve for the other individual. Each point on this curve is therefore Pareto optimal because any move off the contract curve may improve the utility of one individual but will also diminish the utility of the other.

When the original endowment of commodities between the two individuals is such that the distribution of the commodities is not on the contract curve, then they have an interest in exchanging commodities. This would allow one individual to improve his/her total utility, without diminishing the utility of the other. Alternatively, the exchange could raise the utility of both.

Which of the statements best interprets the text:

- A) i) It is assumed that consumer choices are predictable based on previous preferences.
ii) It is assumed that consumer preferences may change with each time a choice is made.
iii) Consumers may derive varying degrees of utility from a fixed quantity of a good, even if their consumption for other goods and their income remains unchanged.
iv) The utility derived from a basket of goods is entirely independent of the utility derived from other goods.

- B) i) Exchanging goods does not necessarily lead to greater optimality for both parties.
ii) Exchanging goods may lead to greater utility from one individual without a reduction in the utility for the other individual.
iii) Reaching Pareto optimality improves the utility of both parties to a trade.
iv) Pareto optimality only arises if the resulting distribution of goods is fair.

- C) i) The contract curve is a set of distributions in which the utility of both parties is maximised for each given distribution of goods.
ii) All points along the contract curve generate the same amount of total utility.
iii) The contract curve will remain the same even if one person's preferences change.
iv) A move along the contract curve necessarily implies that one individual's utility rises at the expense of the other.

* * *

The market mechanism of perfect competition rarely exists in the real world. (The only textbook example of a the perfect market – i.e. a market with homogenous products, single, transparent prices as well as many buyers and sellers – is the stock market.) Usually market sizes are limited in space and time, restricting the number of suppliers and consumers. Products are also varied either naturally or because firms seek specifically to differentiate their own goods. This makes monopolistic competition very prevalent. In other areas, oligopolies dominate markets, notably in the supply of petrol; but media, much transport, computer manufacturing etc., large firms dominate markets too. Monopolies also exist, sometimes because they are created by government (for example, the distribution of letters, or the sale of cigarettes) or because the characteristics of an activity create natural monopolies. The latter include utility industries in particular, such electricity, gas and fixed-line telephony or other network industries like rail. In these industries, the costs of creating the distribution infrastructure are so high that only a single network exists. The monopoly is thus “natural” and is usually owned or regulated by government to ensure that the monopoly power is not abused and that consumers are guaranteed certain minimum services.

The market mechanism will also breakdown where information is not available to the contracting parties or where it is too costly. The problem is particular important where the information is asymmetric: either the buyer or seller holds information the other does not have, and can therefore turn the transaction to his/her advantage unfairly. Typical situations include insurance policies. Bad drivers may know that they are bad risks and will be the first to insure themselves, if policies were just voluntary. Insurance companies would then be faced with a disproportionate number of bad-risk clients, a situation known as adverse selection. Alternatively, adverse selection may also occur when insurance companies try to prevent obvious poor-risk clients from taking out a policy. This is the case for health insurance in particular, where companies will to avoid clients with serious, long-term health problems. Such market failure is one justification of government intervention in this area.

Insurance may also change the way people behave: for example insured drivers are likely to drive less carefully than uninsured drivers. Such behaviour is called moral hazard, meaning that

economic agents are less responsible or less careful when they know that someone will pay for risks they take. To avoid drivers from behaving like this, insurance companies offer “bonuses” for people who avoid accidents.

In extreme cases, the market may then simply stop working. This is true, for example, for high-quality second-hand cars. According to George Akerloff, the fact that it is impossible to judge the exact quality of a second-hand car means that buyers will only buy second-hand cars at a low price, fearing poor quality “lemons” (bad cars). As a result, people wishing to sell high-quality second-hand cars are forced out of the market.

Similar difficulties may arise in a large number of activities, especially services where the consumer cannot properly judge the quality of the product being offered. Again, this is especially a problem in health care as patients often have problems in judging the treatments proposed by doctors. To avoid doctors from abusing this information imbalance, health care is generally a highly regulated activity.

A last, major source of market failure stems from the existence of externalities, in other words costs and benefits of a particular transaction (activity) which are not covered by the monetary transfer which accompanies the transaction.

Such externalities are a particularly significant issue related to environmental problems. Many users of energy or other natural resources do not always pay for the full cost of the resources they are using (or pollution they are creating). As a result, the monetary transaction does not send the right signal, nor impose the full costs of consuming a product on the consumer.

D: According to the above text, are the following statements true or false?

- 1) There are many perfectly competitive markets. (true/false)
- 2) Companies often seek to distinguish their products from those of their competitors. (true/false)
- 3) Monopolies are normally free to exploit their market power. (true/false)
- 4) Certain activities are inherently monopolistic due to their infrastructure costs. (true/false)
- 5) Information about goods and services is frequently hard or expensive to acquire. (true/false)
- 6) Government intervention may be justified to ensure health care for individuals at risk. (true/false)
- 7) Insufficient information may lead to agents withdrawing from the market. (true/false)
- 8) It is easy for patients to assess the quality of treatment offered to them by doctors. (true/false)
- 9) Externalities are an important source of market failure. (true/false)
- 10) They occur when monetary transactions fully reflect the costs and the benefits of market activity. (true/false)

Answers:

A(i), B (ii), C (iv),

D1 false ; D2 true ; D3 false ; D4 true ; D5 true ; D6 true ; D7 true ; D8 false ; D9 true ; D10 fals