

Spring 2017
DUKE UNIVERSITY
Department of Economics

Economics 605: ADVANCED MICROECONOMIC THEORY

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Class: Monday and Wednesday 4:40 – 5:55 Social Psychology 126
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1. **Course description.** This course provides an overview of major theoretical contributions using microeconomic theory along with an introduction to dynamic optimization. The course is intended to give participants a sense of different fields in microeconomics – labor, health, industrial organization, international trade, economic development, urban economics, and more. In the process, students will gain an appreciation of modeling approaches.
2. **Prerequisites.** Econ 601 or equivalent. Working knowledge of multivariate calculus is necessary; some matrix algebra and a cursory overview of the first chapters of a differential equations text will be needed as well. Students are assumed to be familiar with Varian's *Microeconomic Analysis* (Ed. 3) or a comparable text like Jehle & Reny: you should own a copy for reference purposes.
3. **Texts and readings.** There are no texts. Readings (usually) will be posted on Sakai. Instead, the course consists of a vast number of required readings, which each student is expected to cover thoroughly with an eye to content, theory, model, and econometric technique. There are many papers by Nobel Laureates on the reading list.

During the course of the term the list will evolve. It is not possible to cover more than one reading per class period, and so some of the papers will be cut, depending on student interest and what we deem essential and feasible.

4. **Honor code and course policies.** Failure to acknowledge assistance on an assignment, or to cite a source of information used in an assignment, or to represent the work of others as your own, constitutes a violation of the University's honor code. Any violations may result in failure of the assignment or the course, or expulsion from the University. Any exam missed for a non-legitimate reason will be accorded the grade of 0. Any exam missed for a legitimate reason will be made up with an oral exam as soon as it

can be scheduled by EcoTeach. Late work will be penalized by 1/3 grade point per day late (excluding Sundays). Presentation notes must be posted on Sakai at least 24 hours prior to the class at which the presentation will take place.

5. **Grading, assignments, presentations, and attendance.** The grades will be determined as weighted averages of exams and presentations:

Class participation	8%
In-class presentations and supporting notes (3 to 4 per team)	32%
Midterm examination	24%
Final examination or original theory paper	36%

Students also may choose whether to write an original theory paper or to take the final exam. A decision on this choice must be reported to the faculty and TAs by Monday April 4. **In order to receive capstone credit for this course you must write a theory paper.**

6. **Presentations and class conduct.**

To enhance the efficiency of class presentations, each team (3 people) of presenters is expected to prepare a handout for distribution to the entire class. The handout should contain pertinent aspects of the formal presentation to avoid having to write out lots of equations in class. Even if you are not a presenter, you are expected to have read the article in detail before class. The presenters will (a) provide detailed mathematical derivations and (b) make critical analytical comments as well as simply presenting the paper; other students should be prepared to discuss the article. At times, the professors will provide brief background lectures on related literature. The intention is to provoke discussion, and for the presenter to discuss new techniques, modeling approaches, data sets, and findings, as well as to discuss shortcomings.

The exact design of the course will depend on final enrolment. We are projecting a class of about 10 groups. This means that there will be approximately: 4 lectures by faculty and TAs, 1 exam class, at least 2 review sessions, 1 homework session, 1 post midterm session, and 30 presentations for a total of 39 meetings. We have 26 regular class sessions and (since there will be none during the first week) 24 presentation/TA sessions. Students are expected to attend the 4 lectures, the exam, and 25 presentations. We will keep track of attendance and, while exams will have some options, we expect you to attend at least 75% of peer presentations.

Note also that a large share of the papers on the reading list already have presentations posted online. Each team is expected to present:

- One “difficult” (we’ll define these) paper that has not previously been presented;
- One “easy” paper that has not already been presented, **or** a re-presentation of a more difficult paper for which notes already exist;
- One or two elective papers

In addition to student presentations, your instructors will provide mini-presentations of papers we regard as key that are not covered by students, and also will provide background on related papers when appropriate.

Readings (yellow highlight denotes a paper we would very much like to cover – notes are already available on the class website in almost all cases – though since there are 22 that are highlighted, the instructors will present some briefly).

Dates:

Date	Paper	group
Jan 11 Wed	Courant, racial prejudice in a search model	Becker
Jan 12 Thu	Kahneman & Tversky, prospect theory, <i>Econometrica</i> 1979	Becker
Jan 18 Wed	Becker, theory of marriage, <i>JPE</i> 1973	Karol
Jan 19 Thu	Akerlof & Dickens, cognitive dissonance, <i>AER</i> , 1982	Cherry
Jan 23 Mon	Abdulkadiroglu & Sonmez, school choice, <i>AER</i> , 2003	He
Jan 25 Wed	Roth, Sonmez, and Unver, kidney exchange, <i>QJE</i> 2004	
Jan 27 Thu	LaTeX intro	Jiang
Jan 30 Mon	Becker & Murphy, rational addiction, <i>JPE</i> , 1988	He
Feb 1 Wed	Mortensen & Vishwanath, contacts & earnings, <i>Labour Econ</i> , 1994	
Feb 2 Thu	Dynamics intro I: discrete time, Euler equation	Jiang
Feb 6 Mon	Glaeser, hatred, <i>QJE</i> , 2005	Karol
Feb 8 Wed	Banerjee & Mullainathan, temptation, <i>NBER w.p.</i> , 2010	
Feb 9 Thu	Dynamics intro II: Pontryagin's maximum principal	Jiang
Feb 13 Mon	Ambrus <i>et al.</i> , hierarchical cheap talk, <i>Theoretical Econ</i> , 2013	
Feb 15 Wed	Holmstrom & Milgrom, multitask principal agent contracts, <i>JLEO</i> , 1991	
Feb 16 Thu	Stiglitz & Weiss, credit rationing, <i>AER</i> , 1981	
Feb 20 Mon	Holmstrom & Weber, auctions, <i>Econometrica</i> , 1982	
Feb 22 Wed	Alesina & Spolaore, number & size of nations, <i>QJE</i> , 1997	
Feb 23 Thu	Spence, signaling, <i>QJE</i> 1973	
Feb 27 Mon	Grossman & Helpman, protection for sale, <i>AER</i> , 1994	
March 1 Wed	Helsley & Strange, coagglomeration, <i>JPE</i> , 2014	
March 6 Mon	Diamond & Dybvig, bank runs, 1983	
March 8 Wed	Acemoglu & Robinson, why did the West extend the franchise? <i>QJE</i> 2000	
March 9 Thu		
March 13, 15, 16	Spring break	
March 20	Mid-term exam	
March 22 Wed		
March 27 Mon		
March 29 Wed		
March 30 Thu		
April 3 Mon		
April 5 Wed		
April 6 Thu		
April 10 Mon		
April 12 Wed		
April 13 Thu		
April 17 Mon		
April 19 Wed		
May 2 Tue	Final exam 2:00 – 5:00 pm	

I. DYNAMICS AND GETTING STARTED (AND OTHER INTERESTING PAPERS...)

- Michael Intriligator. 1971. *Mathematical Optimization & Economic Theory*. Prentice-Hall, Chs. 11-13.
- Fryer, Roland, and Steven Levitt, 2013, "Hatred and profits: under the hood of the Ku Klux Klan," *Quarterly Journal of Economics*.
- Hall, Robert E., 1988, "Intertemporal substitution in consumption," *Journal of Political Economy* **96**(2): 339-357.
- Leijonhufvud, Axel, 1973, "Life among the econ," *Western Economic Journal* **11**(3): 327-337.
- Lopez-Perez, Raul, and Eli Spiegelman, 2012, "Do economists lie more?" Universidad Autonoma de Madrid, Departamento de Analisis Economico, working paper 4/2012.
- Radford, R.A., 1945, "Economic organization of a POW camp," *Economica* **12**(48): 189-201.
- Schultze Charles L. and Daniel H. Newlon, 2011, *Ten Years and beyond: Economists Answer NSF's Call for Long-Term Research Agendas*. Arlington, VA: National Science Foundation.
- Siegfried, John, 1970, "A first lesson in econometrics," *Journal of Political Economy* **78**(6): 1378-1379.
- Stratton, I.M. and A. Neil, 2004, "How to ensure your paper is rejected by the statistical reviewer," *Diabetic Medicine* **22**: 371-373.
- Thomson, William, 1999, "The young person's guide to writing economic theory," *Journal of Economic Literature* **37**(1): 157-183.

II. RISK & UNCERTAINTY

- Farhi, Emmanuel and Jean Tirole, 2012, "Collective moral hazard, maturity mismatch, and systemic bailouts," *American Economic Review* **102**(1): 60-93.
- Philippson, Thomas and Vasiliki Skreta, 2012, "Optimal interventions in markets with adverse selection," *American Economic Review* **102**(1): 1-28.
- Rothschild, Michael and Joseph Stiglitz. 1976. "Equilibrium in competitive insurance markets: An essay on the economics of imperfect information," *Quarterly Journal of Economics* **90**(4): 629-649.
- Stiglitz, Joseph and Andrew Weiss, 1981, "Credit rationing in markets with imperfect information," *American Economic Review* **71**(3): 393-410.
- Tirole, Jean, 2012, "Overcoming adverse selection: how public intervention can restore market functioning," *American Economic Review* **102**(1): 29-59.

III. HEALTH

- Becker, G. S. and K. Murphy. 1988. "A theory of rational addiction." *Journal of Political Economy* **96**, 675-700.
- Erlich, Isaac and Hiroyuki Chuma, 1990, "A model of the demand for longevity and the value of life extension" *Journal of Political Economy* **98**(4): 761-782.
- Galeotti, Andrea and Brian Rogers, 2013, Strategic immunization and group structure, *American Economic Journal – Microeconomics* **5**(2).
- Grossman, Michael, 1972, "On the concept of health capital and the demand for health," *Journal of Political Economy* **82**: 233-255.
- Ma, Albert Ching-to and Thomas McGuire, 1997, "Optimal health insurance and provider payment," *American Economic Review* **87**(4): 685-704.
- McGuire, Thomas G., and Mark V. Pauly. "Physician response to fee changes with multiple payers." *Journal of Health Economics* **10**, no. 4 (1991): 385-410
- Munz, Philip *et al.*, 2009. Ch. 4 (generalized model of infectious disease) in Tchuenche, JM and C. Chiyaka, Eds. *Infectious Modeling Research Progress*, Nova Science.
- Rosen, Sherwin, 1988, "The value of changes in life expectancy," *Journal of Risk & Uncertainty* **1**: 285-304.

IV. ECONOMICS OF THE HOUSEHOLD & LABOR MARKETS

- Arcidiacono, Peter, Andrew Beauchamp and Marjorie McElroy, 2013, "Terms of endearment: an equilibrium model of sex and matching," Working paper <http://fmwww.bc.edu/EC-P/wp813.pdf>
- Becker, Gary, 1973, "A theory of marriage: part I," *Journal of Political Economy* **81**(4): 813-846
- Becker, Gary, 1974, "A theory of marriage: part II," *Journal of Political Economy* **82**(2): S11-S26.

- Becker, Gary, 1968, "Crime and punishment: an economic approach," *Journal of Political Economy* **76**: 169-217.
- Becker, Gary, and H. Greg Lewis, 1973, "On the interaction between the quality and quantity of children," *Journal of Political Economy* **81**: S279-S288.
- Bergstrom, Theodore, 1989, "A fresh look at the rotten kid theorem," *Journal of Political Economy*, **97**(5) 1138-1159. See iff class of functional forms, Proposition 2. http://works.bepress.com/ted_bergstrom/9/
- Boulier, Bryan L. and Mark R. Rosenzweig, (1984) "Schooling, search, and spouse selection: testing economic theories of marriage and household behavior," *Journal of Political Economy*, **92**(4):712-732.
- De la Croix, David and Fabio Mariani, 2015, From polygyny to serial monogamy: a unified theory of marriage institutions, *Review of Economic Studies* **82**(2).
- Diamond, Peter and Botond Köszegi, 2003, "Quasi-hyperbolic discounting and retirement," *Journal of Public Economics* **87**: 1839-1872.
- Dupuy, Arnaud and Alfred Galichon, 2014, Personality traits and the marriage market, *Journal of Political Economy* **122**(6).
- Gronau, Rubin, 1976, "Leisure, home production and work: the theory of the allocation of time revisited," *Journal of Political Economy*, **85**(6).
- Immorlica, Nicole, Rachel Kranton, and Greg Stoddard, "Striving for Status," unpublished ms., 2012.
- Lam, David, 1984 "Marriage Markets and assortative mating with household public goods: Theoretical results and empirical implications," *Journal of Human Resources*, **23**(4):462-487.
- Maccheroni, Fabio, and Massimo Marinacci, 2012, "Social decision theory: choosing within and between groups," *Review of Economic Studies* **79**: 1591-1636.
- McElroy, M. B., and Mary Jean Horney, "Nash-bargained household decisions: toward a generalization of the theory of consumer demand," *International Economic Review* **22**(2):333-349.
- McGuire, Thomas G., and Mark V. Pauly, 1991, "Physician response to fee changes with multiple payers." *Journal of Health Economics* **10**(4).
- Maestri, Lucas, 2012, "Bonus payments vs. efficiency wages in the repeated principal agent model with subjective evaluations," *American Economic Journal: Microeconomics* **4**(3): 34-56.
- Matouschek, Niko and Imran Rasul (2008), "The economics of the marriage contract: theories and evidence," *Journal of Law and Economics*, **51**: 59-110. http://www.ucl.ac.uk/~uctpimr/research/JLE_marriage.pdf
- Mell, Andrew, 2011, "Are 'gangstas' peacocks? The handicap principle and illicit markets," Oxford, UK: University of Oxford Department of Economics discussion paper.
- Mookherjee, Dilip, Silvia Prina, and Debraj Ray, 2012, "A theory of occupational choice with endogenous fertility," *American Economic Journal: Microeconomics* **4**(4): 1-34.
- Mortensen, Dale and Tara Vishwanath, 1994, "Personal contacts and earnings: It is who you know," *Labour Economics* **1**: 187-201.
- Shin, Wiroy, 2015, Discrimination in organizations: optimal contracts and regulation, Penn State Dept of Economics <http://www.wiroy-shin.com/research/>
- Spence, Michael, 1973, "Job market signaling," *Quarterly Journal of Economics* **87**(3): 355-374. [Becker]
- Streufert, Peter, "The effect of underclass social isolation on schooling choice," 2000, *Journal of Public Economic Theory* **2**(4): 461-482.
- Willis, Robert T. "A theory of out-of-wedlock childbearing," 1999, *Journal of Political Economy*, **107**(6): S33-S64

V. ECONOMIC DEVELOPMENT

- Ahlin, Christian and Robert Townsend, 2007, "Using repayment data to test across models of joint liability lending," *Economic Journal* **117**(517): F11-F51. []
- Banerjee, Abhijit and Sendhil Mullainathan, 2010, "The shape of temptation: implications for the economic lives of the poor," Cambridge, MA: *NBER working paper 15973*.
- Bardhan, Pranab, Dilip Mookherjee, and Masatoshi Tsumagari, 2013, "Middlemen margins and globalization," *American Economic Journal – Microeconomics* **5**(4): 81-119.
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- Basu, Karna, 2011, "Hyperbolic discounting and the sustainability of rotational savings arrangements," *American Economic Journal – Microeconomics* 3(4): 143-171.
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- Kalemli-Ozcan, Sebnem, Harl Ryder, and David Weil, 2000, "Mortality decline, human capital investment, and economic growth," *Journal of Development Economics* 62(1): 1-23.
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- Stiglitz, Joseph, 1974, "Alternative theories of wage determination and unemployment in LDCs: the labor turnover model," *Quarterly Journal of Economics* 81: 194-227. []
- Wang, Xiao Yu, 2015, "Endogenous insurance and informal relationships," unpublished manuscript, Durham, NC: Duke University Department of Economics.

VI. FIRMS, INFORMATION, GOODS, & MECHANISM DESIGN

- Abdulkadiroglu, Atila and Tayfun Sonmez, 2003, School choice: a mechanism design approach, *American Economic Review* 93(1): 729-747.
- Alchian, Armen and Harold Demsetz, 1972, "Production, information costs, and economic organization," *American Economic Review* 62(5): 777-795.
- Ambrus, Attila, Eduardo Azevedo, and Yuchiro Kamada, "Hierarchical cheap talk," *Theoretical Economics*, 2013.
- Athey, Susan, and Armin Schmutzler, 1995, "Product and process flexibility in an innovative environment," *Rand Journal of Economics* 26(4): 557-574.
- Baron, David and Roger Myerson, 1982, "Regulating a monopolist with unknown costs," *Econometrica* 50(4): 911-930.
- Baumol, William J. and Robert D. Willig, 1981, "Fixed costs, sunk costs, entry barriers, and sustainability of monopoly," *Quarterly Journal of Economics* 96(3): 405-431.
- Ben Porath, Elchanan, Eddie Dekel, and Barton Lipman, 2014, "Optimal allocation with costly verification," *American Economic Review* 104(12): 3779-3813.
- Benabou, Roland, 2013, "Groupthink: collective delusions in organizations and markets," *Review of Economic Studies* 80(2): 429-462.
- Diamond, Peter, 1967, "The role of a stock market in a general equilibrium model with technological uncertainty," *American Economic Review* 57(4): 759-776.
- Hartline, Jason and Brendan Lucier, 2015, Non-optimal mechanism design, *American Economic Review* 105(10).
- Holmstrom, Bengt and Paul Milgrom, 1991, "Multitask principal-agent analyses: incentive contracts, asset ownership, and job design," *Journal of Law, Economics & Organization* 7(special issue): 24-52.
- Lewis, Tracy and Huseyin Yildirim, 2002, "Managing dynamic competition," *American Economic Review* 92(4): 779-797.
- McAdams, David, 2011, "Performance and turnover in a stochastic partnership," *American Economic Journal – Microeconomics* 3(4): 107-142.
- Milgrom, Paul and John Roberts, 1990, "The economics of modern manufacturing: technology, strategy, and organization," *American Economic Review* 80(3): 511-528
- Milgrom, Paul and Robert Weber, 1982, "A theory of auctions and competitive bidding," *Econometrica* 50(5): 1089-1122.
- Mirman, Leonard, Larry Samuelson, and Amparo Urbano, 1993, "Monopoly experimentation," *International Economic Review* 34(3): 549-563.
- Panzar, John C. and Robert D. Willig, 1977, "Free entry and the sustainability of natural monopoly," *Bell Journal of Economics* 8(1): 1-22.
- Prat, Andrea, 2005, "The wrong kind of transparency," *American Economic Review* 95(3): 862-877.
- Radner, Roy, 1968, "Competitive equilibrium under uncertainty," *Econometrica* 36(1): 31-58.
- Rubinstein, Ariel and Asher Wolinsky, 1985, "Equilibrium in a market with sequential bargaining," *Econometrica* 53(5): 1133-1150.
- Stigler, George, 1961, "The economics of information," *Journal of Political Economy* 69(3): 213-225.
- Stiglitz, Joseph and Avinash Dixit, 1977, "Monopolistic competition and optimum product diversity," *American Economic*

Review **67**: 297-308.

Taylor, Curtis, 1999, "Time-on-the-market as a sign of quality," *Review of Economic Studies* **66**(3): 555-578.

VII. BARGAINING THEORY

- Abdulkadiroğlu, Atila, and Kyle Bagwell, 2013, "Trust, reciprocity, and favors in cooperative relationships," *American Economic Journal – Microeconomics* **5**(2): 213-259.
- Ambrus, Attila, Eric Chaney, and Igor Salitskiy, forthcoming, "Pirates of the Mediterranean: an empirical investigation of bargaining with transaction costs," *Theoretical Economics*.
- Athey, Susan, 2001, "Single crossing properties and the existence of pure strategy equilibria in games of incomplete information," *Econometrica* **69**(4): 861-889.
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- Green, Edward and Robert Porter, 1984, "Noncooperative collusion under imperfect price information," *Econometrica* **52**(1): 87-100.
- Halac, Marina, 2012, "Relational contracts and the value of relationships," *American Economic Review*, **102**(2): 750-779.
- Kalai, E. and Smorodinsky, M., 1975, "Other solutions to Nash's bargaining problem," *Econometrica* **43**, 513-518.
- Kıbrıs Ö and Tapkı İ.G., 2010, "Bargaining with nonanonymous disagreement: Decomposable Rules," *Games & Economic Behavior*, **68**(1), 233-241
- Kreps, David, Paul Milgrom, John Roberts, and Robert Wilson, 1982, "Rational cooperation in the finitely repeated prisoner's dilemma," *Journal of Economic Theory* **27**(2): 245-252. [TBD]
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VIII. SINGLE PEAKED PREFERENCES

- Kıbrıs Ö. and Küçükşenel S., 2009, "Uniform trade rules for uncleared markets", *Social Choice and Welfare*, **32**(1), 101-121
- Moulin, H., 1980, "On strategy-proofness and single peakedness," *Public Choice*, **35**(4): 437-455.
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IX. MANIPULATION OF ALLOCATION RULES

- Hurwicz, L., 1972, "On informationally decentralized systems", in *Decision and Organization* (McGuire and Radner, Eds.), pp.297-336, North-Holland, Amsterdam.
- Maniquet, F., Sprumont, Y., 1999, "Efficient strategy-proof allocation functions in linear production economies," *Economic Theory* **14**: 583--595.
- Serizawa, S., 1999, "Strategy-proof and symmetric social choice functions for public good economies," *Econometrica* **67**: 121--145.
- Taylor, Curtis, 1995, "Digging for golden carrots: an analysis of research tournaments," *American Economic Review* **85**(4): 872-890.
- Taylor, Curtis, and Huseyin Yildirim, 2010, "Subjective performance and the value of blind evaluation," *Review of Economic Studies* **78**: 762-794.
- Zhou, L., 1991, "Inefficiency of strategy-proof allocation mechanisms in pure exchange economies," *Social Choice and Welfare*, **8**:247-257.

X. MATCHING

- Abdulkadiroğlu A. and T. Sönmez, 1998, "Random serial dictatorship and the core from random endowments in house allocation problems," *Econometrica* **66**: 689-701.
- Abdulkadiroglu, Atila, Yeon-Koo Che, and Yosuke Yasuda, 2015, Expanding "choice" in school choice, *American Economic Journal – Microeconomics* **7**(1).
- Antler, Yair, 2015, Two-sided matching with endogenous preferences, *American Economic Journal – Microeconomics* **7**(3).
- Ashlagi, Itai and Alvin Roth, 2014, Free riding and participation in large-scale, multi hospital kidney exchange, *Theoretical Economics* **9**.
- Banerjee, Abhijit, Esther Duflo, Maitreesh Ghatak, and Jean LaFortune, 2013, Marry for what? Caste and mate selection in modern India, *American Economic Journal – Microeconomics* **5**(2). [TBD]
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- Roth, Alvin, Tayfun Sonmez, and M. Utku Unver, 2004, "Kidney exchange," *Quarterly Journal of Economics*, **119**(2): 457-488. <http://kuznets.fas.harvard.edu/~aroth/alroth.html>
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- Sönmez T. and Switzer T., 2013, "Matching with branch-of-choice contracts at the United States Military Academy," *Econometrica*.
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- Sonmez, Tayfun and M. Utku Unver, 2014, "Altruistically unbalanced kidney exchange," *Journal of Economic Theory* **152**.
- Wang, Xiao Yu, 2013, "Interdependent utility and truth-telling in two-side matching," unpublished manuscript, Durham, NC: Duke University Department of Economics.

XI. PROPERTY RIGHTS & CORRUPTION

- Bac, Mehmet, 1996, "Corruption and supervision costs in hierarchies," *Journal of Comparative Economics*, **22**(2): 99-118.
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XII. URBAN & SPATIAL ECONOMICS

- Black, Duncan, and Vernon Henderson, 1999, "A theory of urban growth," *Journal of Political Economy* **107**(2):252-284.
- Bond, Philip and Kathleen Hagerty, 2010, "Predicting crime waves," *American Economic Journal – Microeconomics* **2**(3): 138-159.
- Brueckner, Jan, Jacques-Francois Thisse, and Yves Zenou, 1999, "Why is central Paris rich and downtown Detroit poor? An amenity-based theory," *European Economic Review* **43**(1): 91-107.
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- Head, Allen and Huw Lloyd-Ellis, 2012, "Housing liquidity, mobility, and the labour market," *Review of Economic Studies* **79**(4): 1559-1590.
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