

Microeconomic Theory III

3rd period , Spring 2019

Mikko Mustonen

Instructions for writing the essay

This assignment allows you to show your ability to apply the material taught in this course in an independent manner. I suggest here two possible types of essays that you could submit. If you would like a different format, feel free to contact me and I will see if your proposal is acceptable for this course.

The general instructions are as follows. The essay should be typewritten and it should be either in English or Finnish. You should discuss all the relevant material, but you should also try to be concise. It is hard for me to see why any essay should be longer than 8 pages with line spacing 1.5. The essay is to be returned by 16.2.2019. Obviously the easiest way to return it is by inserting it to the assignment slot on the course page. Alternatively, you may leave a hard copy of the essay in my pigeonhole at the end of the second floor corridor (with text Hanken on top) at Arkadiankatu 7 (Economicum building) or you may return the essay to me after lectures.

1. Analysis of a real world industry

In this assignment, you may pick an industry that you find interesting and analyze its behavior using the tools developed in the lectures and in the book. Here are some suggestions for the points to be included in your essay. You will get extra credit if you can identify a topical research question so that you do not simply give a description of some industry (but this too will be acceptable).

-Definition of the industry. Give an argument for your chosen boundaries of your industry. (You may have chosen a particular geographic market, the neighbors may also be nearby in the sense of product characteristics). Describe other nearby industries and discuss why your industry can be analyzed in isolation.

-Industry structure. How concentrated is your industry? Is there a dominant firm in your industry? What determines the industry structure? Are there barriers to entry or are there legal restrictions to entry? What about the vertical structure of the industry: Is there a chain of different intermediaries between the producer and the final consumer? Is the industry operating in final goods or intermediate goods, and related to the following point: is the buyer side of the market competitive?

-Demand structure. Is the demand side homogenous? Are there separate submarkets within the industry? Can you see evidence of price discrimination? Is buyer power an issue in this market?

-Performance in the industry. Can you find evidence of the profitability of the companies in the industry? Can you relate the profit levels or mark-ups to similar industries in other countries? For this point in particular, it would also be very interesting to hear how you would go about measuring the performance in the industry if you had sufficient time for proper data gathering.

- Dynamic aspects of the industry. Is this a declining industry or a growing industry? Have there been mergers in the recent past? Do you foresee future mergers or exits? Can the products of the firms be easily copied by others? Do you believe that strong market position in this industry is easy to keep?

-Public policy in the industry. Do political decision makers play a role in this industry through regulation or through taxes and subsidies? Discuss potential changes in the current regulatory setting. What would be the advantages? What would be the disadvantages?

-Keep in mind that I allow also an essay that focuses on a very specific topic such as 'Should mobile phones be bundled with the packages offered by the operators?' , "'Should over the counter pharmaceuticals be sold in supermarkets?' , 'How will Google-Android environment affect the mobile phone market?' For such essays you will not have to have a full discussion of all the points here, but just concentrate on the relevant points.

2. Summary of a classic article in the area

In this assignment you are meant to read carefully one of the articles in the following list. You must also write a summary of the paper in your own words where you demonstrate that you have understood why the article is important. For this, you probably want to relate the article to other existing literature. You may also want to comment on how the literature has proceeded after the article was written (for this you obviously must find material from other sources). You should also show that you understand how the analytics in the article work. Work out some simplified examples of your own and consult other secondary material to get help on this. A critical approach to the article that you read is encouraged. A good critique of the assumptions, techniques or modeling choices made in the article is a way to show that you really understand the issues.

List of possible articles:

· M. Mussa and S. Rosen, "Monopoly and Product Quality", *Journal of Economic Theory*, 1978, 18, 301-317.

· E. Maskin and J. Riley, "Monopoly with Incomplete Information", *Rand Journal of Economics*, 1984, 15, 171-196.

- R.P. McAfee, J. McMillan and M. Whinston, "Multiproduct Monopoly, Commodity Bundling and Correlation of Values", *Quarterly Journal of Economics*, 1989, 371-383.
- D. Kreps and J. Scheinkman, "Quantity Precommitment and Price Competition Yield Cournot Outcomes", *Bell Journal of Economics*, Autumn 1983, 326-37.
- C. Fershtman and K. Judd, "Equilibrium Incentives in Oligopoly", *American Economic Review*, December 1987, 927-40.
- A. Dixit and J. Stiglitz, "Monopolistic Competition and Optimum Product Diversity", *American Economic Review*, 1977, 297-308.
- A. Shaked and J. Sutton, "Relaxing Price Competition Through Product Differentiation", *Review of Economic Studies*, 1982, 3-13.
- J. Rotemberg and G. Saloner, "A Supergame- Theoretic Model of Business Cycles and Price Wars During Booms", *American Economic Review*, June 1986, 390-407.
- K. Bagwell and R. Staiger, "Collusion over the Business Cycle", *Rand Journal of Economics*, 1997, 82-106.
- D. Bernheim and M. Whinston, "Multimarket Contact and Collusive Behavior", *Rand Journal of Economics*, 1990, 1-26.
- E. Green and R. Porter, "Noncooperative Collusion Under Imperfect Price Information", *Econometrica*, 1984, 87-100. P. Aghion and P. Bolton, "Contracts as a Barrier to Entry", *American Economic Review*, 1987, 388-401.
- P. Ghemawat and B. Nalebuff, "Exit", *Rand Journal of Economics*, 1985, 184-94.
- Butters, G., "Equilibrium Distributions of Sales and Advertising Prices," *Review of Economic Studies* 44, 465-91 (1980).
- S. Salop and J. Stiglitz, "Bargains and Ripoffs", *Review of Economic Studies*, 1977, 493-510.
- H. Varian, "A Model of Sales", *American Economic Review*, 1980, 651-659.