

Contents

Preface xiii

PART ONE: INDIVIDUAL DECISION MAKING 3

Chapter 1. Preference and Choice 5

- 1.A Introduction 5
- 1.B Preference Relations 6
- 1.C Choice Rules 9
- 1.D The Relationship between Preference Relations and Choice Rules 11
- Exercises 15

Chapter 2. Consumer Choice 17

- 2.A Introduction 17
- 2.B Commodities 17
- 2.C The Consumption Set 18
- 2.D Competitive Budgets 20
- 2.E Demand Functions and Comparative Statics 23
- 2.F The Weak Axiom of Revealed Preference and the Law of Demand 28
- Exercises 36

Chapter 3. Classical Demand Theory 40

- 3.A Introduction 40
- 3.B Preference Relations: Basic Properties 41
- 3.C Preference and Utility 46
- 3.D The Utility Maximization Problem 50
- 3.E The Expenditure Minimization Problem 57
- 3.F Duality: A Mathematical Introduction 63
- 3.G Relationships between Demand, Indirect Utility, and Expenditure Functions 67
- 3.H Integrability 75
- 3.I Welfare Evaluation of Economic Changes 80
- 3.J The Strong Axiom of Revealed Preference 91

Appendix A: Continuity and Differentiability Properties of Walrasian Demand 92

Exercises 96

Chapter 4. Aggregate Demand 105

- 4.A Introduction 105
- 4.B Aggregate Demand and Aggregate Wealth 106

4.C	Aggregate Demand and the Weak Axiom	109
4.D	Aggregate Demand and the Existence of a Representative Consumer	116
	Appendix A: Regularizing Effects of Aggregation	122
	Exercises	123
Chapter 5. Production 127		
5.A	Introduction	127
5.B	Production Sets	128
5.C	Profit Maximization and Cost Minimization	135
5.D	The Geometry of Cost and Supply in the Single-Output Case	143
5.E	Aggregation	147
5.F	Efficient Production	149
5.G	Remarks on the Objectives of the Firm	152
	Appendix A: The Linear Activity Model	154
	Exercises	160
Chapter 6. Choice Under Uncertainty 167		
6.A	Introduction	167
6.B	Expected Utility Theory	168
6.C	Money Lotteries and Risk Aversion	183
6.D	Comparison of Payoff Distributions in Terms of Return and Risk	194
6.E	State-dependent Utility	199
6.F	Subjective Probability Theory	205
	Exercises	208
PART TWO: GAME THEORY 217		
Chapter 7. Basic Elements of Noncooperative Games 219		
7.A	Introduction	219
7.B	What Is a Game?	219
7.C	The Extensive Form Representation of a Game	221
7.D	Strategies and the Normal Form Representation of a Game	228
7.E	Randomized Choices	231
	Exercises	233
Chapter 8. Simultaneous-Move Games 235		
8.A	Introduction	235
8.B	Dominant and Dominated Strategies	236
8.C	Rationalizable Strategies	242
8.D	Nash Equilibrium	246
8.E	Games of Incomplete Information: Bayesian Nash Equilibrium	253
8.F	The Possibility of Mistakes: Trembling-Hand Perfection	258
	Appendix A: Existence of Nash Equilibrium	260
	Exercises	262

Chapter 9. Dynamic Games 267

- 9.A Introduction 267
- 9.B Sequential Rationality, Backward Induction, and Subgame Perfection 268
- 9.C Beliefs and Sequential Rationality 282
- 9.D Reasonable Beliefs and Forward Induction 292
- Appendix A: Finite and Infinite Horizon Bilateral Bargaining 296
- Appendix B: Extensive Form Trembling-Hand Perfect Nash Equilibrium 299
- Exercises 301

PART THREE: MARKET EQUILIBRIUM AND MARKET FAILURE 307

Chapter 10. Competitive Markets 311

- 10.A Introduction 311
- 10.B Pareto Optimality and Competitive Equilibria 312
- 10.C Partial Equilibrium Competitive Analysis 316
- 10.D The Fundamental Welfare Theorems in a Partial Equilibrium Context 325
- 10.E Welfare Analysis in the Partial Equilibrium Model 328
- 10.F Free-Entry and Long-Run Competitive Equilibria 334
- 10.G Concluding Remarks on Partial Equilibrium Analysis 341
- Exercises 344

Chapter 11. Externalities and Public Goods 350

- 11.A Introduction 350
- 11.B A Simple Bilateral Externality 351
- 11.C Public Goods 359
- 11.D Multilateral Externalities 364
- 11.E Private Information and Second-Best Solutions 368
- Appendix A: Nonconvexities and the Theory of Externalities 374
- Exercises 378

Chapter 12. Market Power 383

- 12.A Introduction 383
- 12.B Monopoly Pricing 384
- 12.C Static Models of Oligopoly 387
- 12.D Repeated Interaction 400
- 12.E Entry 405
- 12.F The Competitive Limit 411
- 12.G Strategic Precommitments to Affect Future Competition 414
- Appendix A: Infinitely Repeated Games and the Folk Theorem 417
- Appendix B: Strategic Entry Deterrence and Accommodation 423
- Exercises 428

Chapter 13. Adverse Selection, Signaling, and Screening	436
13.A Introduction	436
13.B Informational Asymmetries and Adverse Selection	437
13.C Signaling	450
13.D Screening	460
Appendix A: Reasonable-Beliefs Refinements in Signaling Games	467
Exercises	473
Chapter 14. The Principal-Agent Problem	477
14.A Introduction	477
14.B Hidden Actions (Moral Hazard)	478
14.C Hidden Information (and Monopolistic Screening)	488
14.D Hidden Actions and Hidden Information: Hybrid Models	501
Appendix A: Multiple Effort Levels in the Hidden Action Model	502
Appendix B: A Formal Solution of the Principal-Agent Problem with Hidden Information	504
Exercises	507
PART FOUR: GENERAL EQUILIBRIUM	511
Chapter 15. General Equilibrium Theory: Some Examples	515
15.A Introduction	515
15.B Pure Exchange: The Edgeworth Box	515
15.C The One-Consumer, One-Producer Economy	525
15.D The 2×2 Production Model	529
15.E General Versus Partial Equilibrium Theory	538
Exercises	540
Chapter 16. Equilibrium and Its Basic Welfare Properties	545
16.A Introduction	545
16.B The Basic Model and Definitions	546
16.C The First Fundamental Theorem of Welfare Economics	549
16.D The Second Fundamental Theorem of Welfare Economics	551
16.E Pareto Optimality and Social Welfare Optima	558
16.F First-Order Conditions for Pareto Optimality	561
16.G Some Applications	566
Appendix A: Technical Properties of the Set of Feasible Allocations	573
Exercises	575
Chapter 17. The Positive Theory of Equilibrium	578
17.A Introduction	578
17.B Equilibrium: Definitions and Basic Equations	579
17.C Existence of Walrasian Equilibrium	584

17.D	Local Uniqueness and the Index Theorem	589
17.E	Anything Goes: The Sonnenschein–Mantel–Debreu Theorem	598
17.F	Uniqueness of Equilibria	606
17.G	Comparative Statics Analysis	616
17.H	Tâtonnement Stability	620
17.I	Large Economies and Nonconvexities	627
	Appendix A: Characterizing Equilibrium through Welfare Equations	630
	Appendix B: A General Approach to the Existence of Walrasian Equilibrium	632
	Exercises	641
Chapter 18. Some Foundations for Competitive Equilibria 652		
18.A	Introduction	652
18.B	Core and Equilibria	652
18.C	Noncooperative Foundations of Walrasian Equilibria	660
18.D	The Limits to Redistribution	665
18.E	Equilibrium and the Marginal Productivity Principle	670
	Appendix A: Cooperative Game Theory	673
	Exercises	684
Chapter 19. General Equilibrium Under Uncertainty 687		
19.A	Introduction	687
19.B	A Market Economy with Contingent Commodities: Description	688
19.C	Arrow–Debreu Equilibrium	691
19.D	Sequential Trade	694
19.E	Asset Markets	699
19.F	Incomplete Markets	709
19.G	Firm Behavior in General Equilibrium Models Under Uncertainty	713
19.H	Imperfect Information	716
	Exercises	725
Chapter 20. Equilibrium and Time 732		
20.A	Introduction	732
20.B	Intertemporal Utility	733
20.C	Intertemporal Production and Efficiency	736
20.D	Equilibrium: The One-Consumer Case	743
20.E	Stationary Paths, Interest Rates, and Golden Rules	754
20.F	Dynamics	759
20.G	Equilibrium: Several Consumers	765
20.H	Overlapping Generations	769
20.I	Remarks on Nonequilibrium Dynamics: Tâtonnement and Learning	778
	Exercises	782

PART FIVE: WELFARE ECONOMICS AND INCENTIVES 787

Chapter 21. Social Choice Theory 789

- 21.A Introduction 789
- 21.B A Special Case: Social Preferences over Two Alternatives 790
- 21.C The General Case: Arrow's Impossibility Theorem 792
- 21.D Some Possibility Results: Restricted Domains 799
- 21.E Social Choice Functions 807
- Exercises 812

Chapter 22. Elements of Welfare Economics and Axiomatic Bargaining 817

- 22.A Introduction 817
- 22.B Utility Possibility Sets 818
- 22.C Social Welfare Functions and Social Optima 825
- 22.D Invariance Properties of Social Welfare Functions 831
- 22.E The Axiomatic Bargaining Approach 838
- 22.F Coalitional Bargaining: The Shapley Value 846
- Exercises 850

Chapter 23. Incentives and Mechanism Design 857

- 23.A Introduction 857
- 23.B The Mechanism Design Problem 858
- 23.C Dominant Strategy Implementation 869
- 23.D Bayesian Implementation 883
- 23.E Participation Constraints 891
- 23.F Optimal Bayesian Mechanisms 897
- Appendix A: Implementation and Multiple Equilibria 910
- Appendix B: Implementation in Environments with Complete Information 912
- Exercises 918

MATHEMATICAL APPENDIX 926

- M.A Matrix Notation for Derivatives 926
- M.B Homogeneous Functions and Euler's Formula 928
- M.C Concave and Quasiconcave Functions 930
- M.D Matrices: Negative (Semi)Definiteness and Other Properties 935
- M.E The Implicit Function Theorem 940
- M.F Continuous Functions and Compact Sets 943
- M.G Convex Sets and Separating Hyperplanes 946
- M.H Correspondences 949
- M.I Fixed Point Theorems 952
- M.J Unconstrained Maximization 954
- M.K Constrained Maximization 956
- M.L The Envelope Theorem 964
- M.M Linear Programming 966
- M.N Dynamic Programming 969

Index 971