CONTENTS

vii

	Preface	xv
1	Comparative Statics and the Paradigm of Economics	1
1.1	Introduction	1
1.2	The Marginalist Paradigm	3
1.3	Theories and Refutable Propositions	9
	The Structure of Theories	10
	Refutable Propositions	12
1.4	Theories Versus Models; Comparative Statics	14
1.5	Examples of Comparative Statics	16
	Problems	23
	Selected References	24
	Bibliography	24
2	Review of Calculus (One Variable)	25
2.1	Functions, Slopes, and Elasticity	25
2.2	Maxima and Minima	27
2.3	Continuous Compounding	28
2.4	The Mean Value Theorem	31
2.5	Taylor's Series	32
	Applications of Taylor's Series: Derivation of the First- and Second- Order	
	Conditions for a Maximum; Concavity and Convexity	34
3	Functions of Several Variables	37
3.1	Functions of Several Variables	37
	Level Curves: I	37
3.3	Partial Derivatives	39
	·	

•••	
viii	CONTENTS

3.4	The Chain Rule	45
	Second Derivatives by the Chain Rule	47
3.5	Level Curves: II	49
	Convexity of the Level Curves Monotonic Transformations and Diminishing Marginal Utility	51 53
	Problems	55
3.6	Homogeneous Functions and Euler's Theorem	56
5.0	Problems	65
	Selected References	65
4	Profit Maximization	66
4.1	Unconstrained Maxima and Minima: First-Order Necessary Conditions	66
4.2	Sufficient Conditions for Maxima and Minima: Two Variables	68
	Problems	72
4.3	An Extended Footnote	73
4.4	An Application of Maximizing Behavior: The Profit-Maximizing Firm	74
	The Supply Function	81
4.5	Homogeneity of the Demand and Supply Functions; Elasticities	82
	Elasticities	83
4.6	The Long Run and the Short Run: An Example of the Le Châtelier Principle	84
	A More Fundamental Look at the Le Châtelier Principle Problems	86 87
4.7	Analysis of Finite Changes: A Digression	91
7.7	Appendix	92
	Taylor Series for Functions of Several Variables	92
	Concavity and the Maximum Conditions	93
	Selected References	95
5	Matrices and Determinants	96
5.1	Matrices	96
5.2	Determinants, Cramer's Rule	98
5.3	The Implicit Function Theorem	105
	Problems	109
	Appendix	110
	Simple Matrix Operations	110
	The Rank of a Matrix The Inverse of a Matrix	112
	Orthogonality	113 115
	Problems	116
	Selected References	116
6	Comparative Statics: The Traditional Methodology	117
6.1	Introduction; Profit Maximization Once More	117
6.2	Generalization to n Variables	121
	First-Order Necessary Conditions	121
	Second-Order Sufficient Conditions	121
	Profit Maximization: n Factors	124

	CON	NTENTS	ix
c 2 '	The Theory of Constrained Maxima and Minima: First-Order		
	Necessary Conditions		128
6.4	Constrained Maximization with More than One Constraint: A Digression		132
	Second-Order Conditions		134
0.5	The Geometry of Constrained Maximization		138
6.6	General Methodology		141
	Problems		148
	Selected References		150
7	The Envelope Theorem and Duality		151
7.1	History of the Problem		151
	The Profit Function		152
	General Comparative Statics Analysis: Unconstrained Models		156
7.4	Models with Constraints		159
	Comparative Statics: Primal-Dual Analysis		161
	An Important Special Case		165
	Interpretation of the Lagrange Multiplier		166
	Le Châtelier Effects		169
	Problems		172 174
	Bibliography		1/4
8	The Derivation of Cost Functions		175
8.1	The Cost Function		175
8.2	Marginal Cost		179
8.3	Average Cost		180
8.4	A General Relationship Between Average and Marginal Costs		181
8.5	The Cost Minimization Problem		183
8.6	The Factor Demand Curves		189
	Interpretation of the Lagrange Multiplier		189
8.7	Comparative Statics Relations: The Traditional Methodology		193 202
8.8	Comparative Statics Relations Using Duality Theory		202
	Reciprocity Conditions		205
	Cost Curves in the Short and Long Run		207
	Factor Demands in the Short and Long Run Relation to Profit Maximization		209
0.0	Elasticities; Further Properties of the Factor Demand Curves		211
8.9	Homogeneity		212
	Output Elasticities		216
8 10	The Average Cost Curve		216
	Analysis of Firms in Long-Run Competitive Equilibrium		218
0.11	Analysis of Factor Demands in the Long Run		220
	Problems		222
	Selected References		224
9	Cost and Production Functions: Special Topics		225
9.1	Homogeneous and Homothetic Production Functions		225
9.1	The Cost Function: Further Properties		228
9.2	Homothetic Functions		232

Homothetic Functions

9.3	The Duality of Cost and Production Functions	234
9.4	The Importance of Duality Flasticity of Substitution: the Constant Flasticity of Substitution: (GPG)	237
7.4	Elasticity of Substitution; the Constant-Elasticity-of-Substitution (CES) Production Function	
	Generalizations to <i>n</i> Factors	238
	The Generalized Leontief Cost Function	248
	Problems	249
	Bibliography	250
10		250
10	The Derivation of Consumer Demand Functions	252
10.1	Introductory Remarks: The Behavioral Postulates	252
10.2	,	261
	Interpretation of the Lagrange Multiplier	266
10.0	Roy's Identity	268
10.3	Triaximization violet and the Cost	
10.4	Minimization Model	272
10.4	Traditional	
10.5	Derivation of the Slutsky Equation	276
10.5	The Modern Derivation of the Slutsky Equation Conditional Demands	282
	The Addition of a New Commodity	286
10.6		288
10.0	Real-Income-Held-Constant Demand Curves	201
	The Slutsky Equation in Elasticity Form	291
	Compensated Demand Curves	291
10.7	Special Topics	294 297
	Separable Utility Functions	297
	The Labor-Leisure Choice	299
	Slutsky Versus Hicks Compensations	304
	The Division of Labor Is Limited by the Extent of the Market	306
	Problems	310
	Selected References	313
11	Special Tonics in Consuman Theory	
	Special Topics in Consumer Theory	314
11.1	Revealed Preference and Exchange	314
11.2	The Strong Axiom of Revealed Preference and Integrability	322
112	Integrability The Community Communit	325
11.3	The Composite Commodity Theorem	332
11.4	Shipping the Good Apples Out	335
11.4	Household Production Functions	341
11.5	Consumer's Surplus	345
11.5	Consumer's Surplus Example	347
	•	354
11.6	Empirical Approximations Empirical Estimation and Functional Forms	355
1.0	Linear Expenditure System	357
	CES Utility Function	357
	Indirect Addilog Utility Function	359
		360

		CONTENTS	хi
	Translog Specifications		361
	Almost Ideal Demand System		362
	Problems		363
	References on Theory		366
	References on Functional Forms		366
12	Intertemporal Choice		368
12.1	n-Period Utility Maximization		368
	Time Preference		371
	Fisherian Investment		378
	The Fisher Separation Theorem		380
	Real Versus Nominal Interest Rates		382
12.2	The Determination of the Interest Rate		384
12.3	Stocks and Flows		387
	Problems		391
	Selected References		392
13	Behavior Under Uncertainty		394
13.1	Uncertainty and Probability		394
	Random Variables and Probability Distributions		395
	Mean and Variance		396
13.2	Specification of Preferences		399
	State Preference Approach		399
	The Expected Utility Hypothesis	•	400
	Cardinal and Ordinal Utility		401
13.3	Risk Aversion		403
	Measures of Risk Aversion		405
	Mean-Variance Utility Function		406
10.4	Gambling, Insurance, and Diversification		409
13.4	1		411
	Allocation of Wealth to Risky Assets		411 412
	Output Decisions Under Price Uncertainty Increases in Riskiness		413
	Problems		416
	Selected References		416
14	Maximization with Inequality and		
	Nonnegativity Constraints		418
14.1	Nonnegativity		418
14.1	Functions of Two or More Variables		423
14.2	Inequality Constraints		427
14.3	The Saddle Point Theorem		432
14.4	Nonlinear Programming		437
14.5	An "Adding-Up" Theorem		440
	Problems		442
	Appendix		443
	Bibliography		446

15	Contracts and Incentives	448
15.1	The Organization of Production	448
15.2	Principal-Agent Models	449
	Comparative Statics	452
	Multitask Agency	454
15.3	Performance Measurement	457
	Choosing the Performance Measure	460
15.4	Costly Monitoring and Efficiency Wages	461
15.5	Team Production	463
15.6	Incomplete Contracts	466
	Factors Affecting Ownership Structure Problems	469
	Selected References	471
	Sciected References	471
16	Markets with Imperfect Information	473
16.1	The Value of Information in Decision Making	473
16.2	Search	474
	Sequential Search	476
160	Equilibrium Price Dispersion	478
16.3	Adverse Selection	482
16.4	Favorable Selection	485
16.4	Signaling A More General Analysis	487
16.5	A More General Analysis Monopolistic Screening	490
10.5	Problems	491
	Selected References	496
		497
17	General Equilibrium I: Linear Models	498
17.1	Introduction: Fixed-Coefficient Technology	498
17.2	The Linear Activity Analysis Model: A Specific Example	507
17.3	The Rybczynski Theorem	513
17.4 17.5	The Stolper-Samuelson Theorem The Dual Problem	515
17.5		517
17.0	The Simplex Algorithm Mathematical Prerequisites	526
	The Simplex Algorithm: Example	526
	Problems	530
	Bibliography	534 536
		330
18	General Equilibrium II: Nonlinear Models	537
18.1	Tangency Conditions	537
18.2	General Comparative Statics Results	545
18.3	The Four Fountier Made and Related Theorems	550
	The Four-Equation Model	556
	The Factor Price Equalization Theorem The Stolper Samuelson Theorems	558
	The Stolper-Samuelson Theorems The Rybczynski Theorem	559
	- Me My oczyniski i neoteni	566

	CONTENTS	xiii
18.4	Applications of the Two-Good, Two-Factor Model	568
18.5	Summary and Conclusions	572
	Problems	574
	Bibliography	576
19	Welfare Economics	577
19.1	Social Welfare Functions	577
19.2	The Pareto Conditions	581
	Pure Exchange	581
	Production	584
19.3	The Classical "Theorems" of Welfare Economics	591
19.4	A "Nontheorem" About Taxation	594
	The Theory of the Second Best	595
	Public Goods	597
	Consumer's Surplus as a Measure of Welfare Gains and Losses	600
19.8	Property Rights and Transactions Costs	604
	The Coase Theorem	608
	The Theory of Share Tenancy: An Application of the Coase Theorem	611
	Problems	615
	Bibliography	616
20	Resource Allocation over Time: Optimal Control Theory	617
20.1	The Meaning of Dynamics	617
	Brief History	621
20.2	Solution to the Problem	621
	The Calculus of Variations	627
	Endpoint (Transversality) Conditions	629
	Autonomous Problems	630
	Sufficient Conditions	632
20.3	Solutions to Differential Equations	633
•••	Simultaneous Differential Equations	636
20.4	Interpretations and Solutions	637
	Intertemporal Choice	637
	Harvesting a Renewable Resource	640
	Capital Utilization	644
	Problems Salasted References	649
	Selected References	650
	Hints and Answers	652
	Index	661