

**Ph.D.**  
**The Economics of Entrepreneurship and Young Firms**

Peter Thompson

Office Hours: Any time

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**Objectives**

In this course we will study the recent theoretical and empirical literature on entrepreneurship, firm formation, and the performance of young firms. As a second-year PhD course the principal objectives of the course are as follows:

1. To develop among participants a thorough familiarity with, and understanding of, a particularly active area of current research.
2. To learn how to read papers critically, with a view to identifying researchable topics.
3. To initiate a transformation among students from consumers of research to producers of research.

**Class organization**

The class meets twice a week, on Tuesdays and Thursdays. The Thursday classes follow a lecture format. I will outline some of the key points in the required reading(s) and explain any tricky (esp. mathematical) bits. Most of the lecture will be focused on providing a context for the paper(s). Specifically, I will focus on questions such as: why was the paper written at that particular time? what existing beliefs or literature was the paper responding to?

The Tuesday meetings are for group discussion format (you are expected to read and make notes on the required paper(s) prior to class). The discussions will focus on questions that might generate new research ideas (e.g. is the theory robust to alternative, plausible assumptions? how might one test the theory? can the empirical work be done better? would the empirical results hold in different samples?). Hence, you should be thinking about these questions while you are reading the papers.

**Grading**

Grading is based on four activities:

1. Participation in class discussions: 25%;
2. A written research proposal, about 4,000 words: 35%;

3. Oral presentation of your research proposal (20 minutes presentation, 10 minutes for questions) 15%;

4. A final exam, 25%.

Grading of participation will inevitably be carried out on rather crude scale. During class discussions, there will be ample opportunity for all members of the class to participate fully, because students who are not participating will be invited to contribute by means of direct questions about the paper(s). If you have read the papers, and thought seriously about some new directions the work could take, you will have no problem with this part of the requirements.

The research proposal should layout in reasonable detail:

- The question you will address, how it derives from the existing literature, and why the question might be of interest to the profession.
- (if theoretical) An outline of the structure of the model, the results you think your model will generate, and the intuition that leads you to expect these results.
- (if empirical) The dataset you plan to use. While you do not need to collect or construct the data, you should verify that the variables you plan to include are more likely than not to be available. In describing the methodology, you should pay very close attention to possible endogeneity problems, and how you plan to resolve them.

While the oral presentation is in one sense a reprise of your research proposal, I will be looking for you to find ways to present your proposal in a manner that is easy for your audience to grasp. Thus, you may choose to present something by means of a numerical example rather than equations, or you may choose to find a succinct way to summarize prior literature.

The final exam focuses more on the lessons learned than on the mathematical details of the papers. To give you an idea of the types of questions I may ask, I will distribute a question bank (which will not include all the questions on the exam!) a couple of weeks before the end of the semester.

### **Notes on the readings**

Each section in the remainder of this syllabus has between one and three required readings. I expect you to have read and thought about these before each Tuesday class. There are also many papers listed under supplementary readings. I do not expect you to have read these (there is no time). In many cases, these are references to papers that I will talk about in the Thursday lectures. You might want to dip into them here and there, to check a result or to verify that they did indeed claim what I said they claimed.

## **Part A. Who Becomes an Entrepreneur?**

### **Week 1. Introduction**

*Traditional models of industry equilibrium (as learned in your first year microeconomics classes) imagine that there exists a pool of atomistic potential entrants standing by ready to*

*enter an industry as soon as it shows above-normal profits. The traditional models are very neat, but largely uninformative. The paper by Geroski documents some surprising facts – for example, high incumbent profits do not predict entry – that might get you to doubt the traditional model. Parker’s review reminds us that firms are founded by **people** rather than by atomistic agents, with social histories and diverse backgrounds, and diverse motivations for founding firms.*

Geroski, Paul A. (1995): “What do we know about entry?” *International Journal of Industrial Organization*, **13**(4):421-440.

Parker, Simon C. (2005): "The economics of entrepreneurship: What we know and what we don't." *Foundations and Trends in Entrepreneurship*, **1**(1):1-54.

#### Supplementary readings

Murray, M. (2006): Avoiding Invalid Instruments and Coping with Weak Instruments, *Journal of Economic Perspectives*, **20**(4):111-132.

### **Week 2. The most and least competent**

*In each of the next three weeks, we consider one of the classic canonical models of entrepreneurial choice. This week we focus on Lucas’ theory of assignment based on ability. Lucas’ model assumes individuals vary in their ability to manage businesses. The most able managers become managers, while the rest become wage workers. While an obvious idea on its face, Lucas’ classic paper also explores the model’s implications for the distribution of firm size and for firm growth.*

Lucas, Robert E., Jr. (1978): “On the size distribution of business firms.” *Bell Journal of Economics*, **9**(2):508-523.

#### Supplementary readings

Jovanovic, Boyan (1994): “Firm formation with heterogeneous management and labor skills.” *Small Business Economics*, **6**(3):185-191.

Jovanovic, Boyan and Peter Rousseau (2001): "Why wait? A century of life before IPO." NBER Working Paper No. W8081.

Rosen, Sherwin (1981): “The economics of superstars.” *American Economic Review*, **71**(6):845-858.

Ohyama, Atsushi (2007): “Entrepreneurship and advanced technical knowledge.” Working paper, SUNY Buffalo.

### **Week 3. The most innovative**

*The notion that the most important function of entrepreneurs is to innovate is attributed to work carried out by Schumpeter prior to WWII. It took a long time for an interesting formal model of innovate entrepreneurship to be developed. Holmes and Schmitz develop a model in which some people are serial innovators, some innovate just once, and others buy and manage businesses founded by others.*

Holmes, Thomas J., and James A. Schmitz, Jr. (1990): "A theory of entrepreneurship and its application to the study of business transfers." *Journal of Political Economy*, **98**(2):265-294.

Supplementary readings

Aghion, P., and J. Tirole. 1994. "On the management of innovation." *Quarterly Journal of Economics*, **109**:1185-1209.

Malmendier, Ulrike and Josh Lerner (2005): "Contractibility and the design of research agreements." NBER Working Paper No. 11292.

Hellman, Thomas F. (2007): "The role of patents for bridging the science to market gap" *Journal of Economic Behavior and Organization*, **63**(4):624-657.

Kortum, Samuel, and Josh Lerner (2000): "Assessing the contribution of venture capital to innovation." *RAND Journal of Economics*, **31**(4): 674–692.

**Week 4. The least risk averse**

*The risk-bearing role of entrepreneurs was first described (in modern terms) by Frank Knight in 1921. Yet again, formal modeling in a manner that would capture the profession's attention took a while. In this lecture, I give a brief overview of the Kihlstrom-Laffont model (the concepts are simple), and then I turn to a review of some of the evidence about risk and return. The evidence is so mixed, that Vereshchagina and Hopenhayn came up with a clever model to explain why risk-averse individuals would invest in risky projects that don't offer higher returns. It's a cool model, worth taking a look at.*

Kihlstrom, Richard E., and Jean-Jacques Laffont (1979): "A general equilibrium entrepreneurial theory of firm formation based on risk aversion." *Journal of Political Economy*, **87**(4):719-748.

Vereshchagina, Galina, and Hugo A. Hopenhayn (2009): "Risk taking by entrepreneurs." *American Economic Review*, **99**(5):1808-1830

Supplementary readings

Rosen, Harvey, and Paul Willen (2002): "Risk, return, and self-employment." Working paper, Department of Economics, Princeton University.

Cramer, J.S., J. Hartog, N. Jonker, C.M. Van Praag (2002): "Low risk aversion encourages the choice for entrepreneurship. An empirical test of a truism." *Journal of Economic Behavior and Organization*, **48**(1):29-36.

Moskowitz, Tobia J., and Annette Vissing-Jørgensen (2002): "The returns to entrepreneurial investment: A private equity premium puzzle?" *American Economic Review*, **92**(4):745-778.

Brockhaus, R. (1980): "Risk-taking propensity of entrepreneurs." *Academy of Management Journal*, **23**(3):509-520.

Wu, Brian, and Anne-Marie Knott (2006): "Entrepreneurial risk and market entry." *Management Science*, **52**(9):1315-1330.

Rigotti, Luca, Matthew Ryan and Rhema Vaithianathan (2005): "Tolerance of ambiguity and entrepreneurial innovation." Working paper, Fuqua School of Business, Duke University.

Busenitz, L.W. (1999): "Entrepreneurial risk and strategic decision making: It's a matter of perspective." *Journal of Applied Behavioral Science*, **35**(3):325-340.

### **Week 5. People with diverse skills**

*Lazear proposed a novel theory that entrepreneurs are selected based on their ability to engage effectively in multiple tasks. In contrast, individuals who are much better at one task than another (even if they are relatively good at both) select wage employment where they specialize in one task. The model is intuitive, but there remains much empirical work to be done. The empirical work to date generally involves linking variety in employment backgrounds to entry into self-employment*

Lazear, Edward P. (2002): "Entrepreneurship." *Journal of Labor Economics*, **23**(4):649-680.

#### Supplementary readings

Åstebro, Thomas, Jing Chen, and Peter Thompson (2008): "Stars and misfits: A theory of occupational choice." "Working Paper, FIU.

Hamilton, Barton (2000): "Does entrepreneurship pay? An empirical analysis of the returns to self-employment," *Journal of Political Economy*, **108**:604-31.

Silva, Olmo (2007): "The Jack-of-all-trades entrepreneur: Innate talent or acquired skill?" *Economics Letters*, **97**(2):118-123.

Wagner, Joachim (2003): "Testing Lazear's Jack-of-all-trades view of entrepreneurship with German microdata," *Applied Economics Letters*, **10**(11):687-689.

Wagner, Joachim (2006): "Are Nascent Entrepreneurs Jacks-of-all-trades? A Test of Lazear's Theory of Entrepreneurship with German Microdata," *Applied Economics*, **38**:2415-19.

### **Week 6. People with a taste for variety**

*One reason that entrepreneurship may be associated with people with varied skills or backgrounds is that entrepreneurship simply attracts people who enjoy doing different things (i.e. who easily get bored by routine). Put another way, the theory states that people who like being entrepreneurs are more likely to become entrepreneurs. This is the sort of quasi-tautological claim that economists usually have some difficulty with! The required reading establishes that there are in fact observable (i.e. testable) implications of such claim.*

Åstebro, Thomas, and Peter Thompson (2008): "Entrepreneurs: Jacks of all trades or hobos?," Working Paper, FIU.

#### Supplementary readings

Benz, Matthias and Bruno S. Frey (2004): "Being Independent Raises Happiness at Work." *Swedish Economic Policy Review*, **11**(2):95-134.

Hyytinen, Ari and Pekka Ilmakunnas (2007): "Entrepreneurial aspirations: Another form of job search?" *Small Business Economics*, **29**(1):63-80.

Munasinghe, Lalith and Karl Sigman (2004): "A Hobo syndrome? Mobility, wages and job turnover." *Labour Economics*, **11**:191-218.

### **Week 7. The rich**

*Capital markets for entrepreneurs do not work efficiently. It then follows that wealth facilitates entry. Evans and Jovanovic were among the first to develop and test a formal model of wealth constraints. A surprising implication of their model (but one that will be easy to explain) is that the most able people are the most likely to be wealth-constrained. The lecture will also review some of the innovative empirical work that has been done to test the theory (most of which has been concerned with the problem of identifying variation in wealth that is uncorrelated with entrepreneurial ability).*

Evans, David S., and Boyan Jovanovic (1989): "An estimated model of entrepreneurial choice under liquidity constraints." *Journal of Political Economy*, **97**(4):808-827.

#### Supplementary readings

Cagetti, Marco, and Mariacristina De Nardi (2006): "Entrepreneurship, frictions, and wealth." *Journal of Political Economy*, **114**(5):835-870.

Chen, Jing (2008): "Wealth constraints and self-employment: Evidence from birth order." Working Paper 08-08, Florida International University.

Holtz-Eakin, Douglas, Joulfaian, David, and Rosen, Harvey S. (1994): "Sticking it out: Entrepreneurial survival and liquidity constraints." *Journal of Political Economy*, **102**(1): 53-75.

Holtz-Eakin, Douglas, David Joulfaian, and Harvey S. Rosen (1994): "Entrepreneurial decisions and liquidity constraints." *RAND Journal of Economics*, **25**(2): 334-347.

Hurst, Erik and Annamaria Lusardi (2004): "Liquidity constraints, household wealth, and entrepreneurship." *Journal of Political Economy*, **112**(2):319-347.

Lindh, Thomas, and Henry Ohlsson (1996): "Self-employment and windfall gains: evidence from the Swedish lottery." *Economic Journal*, **106**(439):1515-1526.

Nanda, Ramana (2008): "Cost of external finance and selection into entrepreneurship." HBS Working Paper 08-047, Harvard Business School.

Xu, Bin (1998): "A re-estimation of the Evans-Jovanovic entrepreneurial choice model." *Economics Letters*, **58**(1):91-95.

Johansson, Edvard (2000): "Self-employment and liquidity constraints: Evidence from Finland." *Scandinavian Journal of Economics*, **102**(1):123-134.

Meyer, Bruce D. (1990): "Why are there so few Black entrepreneurs?" NBER Working Paper no. 3537.

## Week 8. Sneaky people with good ideas

*If entrepreneurs are often innovative, it follows that employees of incumbent firms who leave to form their own company are also often innovative. But what induces a worker to leave and form his or her own company rather than work with his/her employer to implement an idea? The answer turns on the difficulties of writing complete contingent contracts in the face of asymmetric information. Most of the theories about employee spinoffs are based on the notion that ideas occur privately to an employee who may sometimes find it more profitable to implement the idea in a new firm. These theories raise many questions about the correct way to write contracts.*

Chatterjee, Satyajit, and Esteban Rossi-Hansburg (2007): "Spin-offs and the market for ideas." NBER working paper no. 13198.

### Supplementary readings

Amador, Manuel, and Augustin Landier (2003): "Entrepreneurial pressure and Innovation." Working paper.

Anton, James J., and Dennis A. Yao (1995): "Start-ups, spin-offs, and internal projects." *Journal of Law, Economics, and Organization*, **11**:362-378.

Klepper, Steven and Sally D. Sleeper (2005): "Entry by spinoffs." *Management Science*, **51**(8):1291-1306.

Hellman, Thomas (2007): "When do employees become entrepreneurs?" *Management Science*, **53**(6):919-933.

Gromb, Denis, and David Scharfstein (2002): "Entrepreneurship in equilibrium." NBER working paper No. 9001.

Franco, April M., and Darren Filson (2006): "Spin-outs: Knowledge diffusion through employer mobility." *RAND Journal of Economics*, **37**(4):841-860.

Christensen, C.M. (1993): "The rigid disk drive industry: a history of commercial and technological turbulence." *Business History Review*, Winter, 531-88.

Pakes, Ariel, and Shmuel Nitzan (1983): "Optimum contracts for research personnel, research employment, and the establishment of 'rival' enterprises." *Journal of Labor Economics*, **1**(4):345-65.

## Week 9. The frustrated

*Is it true that employees leave with good ideas they fail to reveal to their employees? Klepper and Thompson are skeptical. They develop another approach, in which employees fully reveal their ideas, but in which there is genuine disagreement about their value. In such a setting, how do disagreements arise, and what does this imply for the timing of employee spinoffs?*

Klepper, Steven, and Peter Thompson (2010): "Disagreements and intra-industry spinoffs." *International Journal of Industrial Organization*, **28**(5):526-538.

### Supplementary readings

Thompson, Peter and Jing Chen (2010): "Disagreement, employee spinoffs and the choice of

technology.” FIU working paper.

### **Week 10. The overoptimistic**

*Some people may form businesses because they think they have a good idea when they don't, or they think the environment is more favorable than it really is, or they think they are smarter than they really are. What does overoptimism imply for entry and performance? And what is the evidence for overoptimism? Note that some of this literature contains significant overlaps with the papers on employee spinoffs.*

Bernardo, Antonio, and Ivo Welch (2001): “On the evolution of overconfidence and entrepreneurship.” *Journal of Economics and Management Strategy*, **10**:301-30.

#### Supplementary readings

Landier, Augustin, and David Thesmar (2009): “Financial contracting with optimistic entrepreneurs.” *Review of Financial Studies*, **22**(1):117-150.

Arabsheibani, G., J. de Meza, J. Maloney, and B. Pearson (2000): "And a vision appeared unto them of a great profit." *Economics Letters*, **67**:35-41.

Baron, R. A. (1998): “Cognitive mechanisms in entrepreneurship: Why and when entrepreneurs think differently than other persons.” *Journal of Business Venturing*, **13**:275-294.

Buehler, R., Griffin, D., and M. Ross (1994): Exploring the “planning fallacy”: Why people underestimate their task completion times.” *Journal of Personality and Social Psychology*, **67**:366-381.

Busenitz, L., and J. Barney (1997): “Differences between entrepreneurs and managers in large organizations: Biases and heuristics in strategic decision-making.” *Journal of Business Venturing*, **12**(1):9-30.

Camerer, Colin, and D. Lovallo (1999): “Overconfidence and excess entry: An experimental approach.” *American Economic Review*, **89**:306-318

Cooper, A.C., Woo, C.A., and W. Dunkelberg (1988): “Entrepreneurs perceived chances for success.” *Journal of Business Venturing*, **3**:97-108.

Gervais, S. & Terry Odean (2001): Learning to be overconfident.” *Review of Financial Studies*, **14**(1):1-27.

Gervais, S., Heaton, J. B. & Terry Odean (2004): “Overconfidence, investment policy, and executive stock options.” Working paper, Wharton School.

Griffin, D.W., and Amos Tversky (1992): “The weighing of evidence and the determinants of confidence.” *Cognitive Psychology*, **24**:411-435.

McKenzie, C.R.M. (1997): “Underweighting alternatives and overconfidence.” *Organizational Behavior and Human Decision Processes*, **71**:141-160.

Mahajan, J. (1992): “The overconfidence effect in marketing management predictions.” *Journal of Marketing Research*, **29**:329–342.



Van den Steen, Eric (2004): “Rational overoptimism (and other biases).” *American Economic Review*, **94**(5):1141-51.

## **Part B. The Performance of Young Firms and Industries**

### **Week 11. The persistence of founding conditions**

*It is obvious, and therefore uninteresting, to note that founders of firms who are well prepared or who enter under ideal circumstances, are more likely to survive their first few years. Less obvious, and therefore more interesting, is the fact that founding conditions have influences on survival and performance that may persist for decades after entry. This week, we explore the evidence for the persistence of the effects of founding conditions, and some theories to explain it.*

Klepper, Steven (2002): “The capabilities of new firms and the evolution of the US automobile industry.” *Industrial and Corporate Change*, **11**(4):645-666.

Jovanovic, Boyan, and Peter Rouseau (2001): “Vintage organization capital.” NBER working paper no. 8166.

#### Supplementary readings

Geroski, Paul A., José Mata, and Pedro Portugal (2010): “Founding conditions and the survival of new firms.” *Strategic Management Journal*, **31**(5):510-529.

Johnson, Jay (2003): “The Determinants of Entry: An analysis of entrants and non-entrants into the market for MTBE.” Unpublished paper.

Klepper, Steven, and Kenneth Simons (2000): “Dominance by birthright: entry of prior radio producers and competitive ramifications in the U.S. television receiver industry.” *Strategic Management Journal*, **21**(10-11):997-1016.

Klepper, Steven, and Kenneth Simons (2000): “The making of an oligopoly: Firm survival and technological change in the evolution of the U.S. tire industry.” *Journal of Political Economy*, **108**(4):728-760.

Thompson, Peter (2005): “Selection and firm survival. Evidence from the shipbuilding industry, 1825-1914.” *Review of Economics and Statistics*, **87**(1):26-36.

### **Week 12. SPRING BREAK**

### **Week 13. Firm age and growth**

*For almost 80 years, the standard view of firm growth was that it followed Gibrat’s Law. But new datasets made available in the 1980s began to reveal some subtle deviations from Gibrat’s Law that many economists suspected may have important implications for our understanding of industry evolution. In particular, it was repeatedly shown that firm age has a robust (negative) effect on growth. We begin this week’s lecture by understanding why this was a*

*problem for standard growth models. Three theories are reviewed, each of which offers a different method for linking firm growth and survival to firm age.*

Jovanovic, Boyan (1982): "Selection and the evolution of industry." *Econometrica*, **50**(7):649-670. (read only sections 1-3).

Cooley, Thomas F. and Vincenzo Quadrini (2001): "Financial markets and firm dynamics." *American Economic Review*, **91**(5):1287-1310.

Klepper, Steven, and Peter Thompson (2007): "Submarkets and the evolution of market structure." *RAND Journal of Economics*, **37**(4):862-888.

#### Supplementary readings

Baldwin, John R., Lin Bian, Richard Dupuy, and Guy Gellatly (2000): "Failure rates for new Canadian firms: New perspectives on entry and exit." Working paper, Statistics Canada.

Cabral, Luís, and José Mata (2003): "On the evolution of the firm size distribution: Facts and theory." *American Economic Review*, **93**(4):1075-1090.

Cooley, Thomas F. and Vincenzo Quadrini (2001): "Financial markets and firm dynamics." *American Economic Review*, **91**(5):1287-310.

Disney, Richard, Jonathan Haskel, and Ylva Heden (2000): "Entry, exit and establishment survival in UK manufacturing." Manuscript: Queen Mary and Westfield College, London

Dunne, Timothy, Mark J. Roberts, and Larry Samuelson (1988): "Patterns of firm entry and exit in U.S. manufacturing industries." *RAND Journal of Economics*, **19**(4):495-515.

Dunne, Timothy, Mark J. Roberts, and Larry Samuelson (1989): "The growth and failure of U.S. manufacturing plants." *Quarterly Journal of Economics*, **104**(4):671-698.

Evans, David S. (1987a): "Tests of alternative theories of firm growth." *Journal of Political Economy*, **95**(4):657-674.

Evans, David S. (1987b): "The relationship between firm growth, size, and age: Estimates for 100 manufacturing industries." *Journal of Industrial Economics*, **35**(2):567-581.

Hall, Bronwyn H. (1987): "The relationship between firm size and firm growth in the U.S. manufacturing sector." *Journal of Industrial Economics*, **35**(4):583-606.

Ijiri, Y., and Herbert Simon (1977): *Skew distributions and the sizes of business firms*. New York: North Holland Publishing Co.

Jovanovic, Boyan (1982): "Selection and the evolution of industry." *Econometrica*, **50**(7):649-670.

Klette, Tor Jakob, and Samuel Kortum (2004): "Innovating firms and aggregate innovation." *Journal of Political Economy*, **112**(5):986-1018.

Mata, José, and Pedro Portugal (1994): "Life duration of new firms." *Journal of Industrial Economics*, **27**:227-46.

Persson, Helena (2002): "The survival and growth of new establishments in Sweden, 1987-

1995.” Working paper, Stockholm University.

Sutton, John (1998): *Technology and Market Structure*. Cambridge, MA: MIT Press.

Sutton, John (2002): “The variance of firm growth rates: The ‘scaling’ puzzle.” *Physica A: Statistical Mechanics and its Applications*, **312**(3-4):577-590

#### **Week 14. Industry shakeouts**

*It has been noted that many industries go through a shakeout, a phase characterized by a large increase in output and a concurrent crash in the number of active firms. What drives this? The shakeout seems to be too sharp to just be a gradual rise to dominance of the best firms. The paper by Jovanovic and MacDonald studies the early US tire industry, arguing that the shakeout was driven by a specific technological innovation that raised the minimum efficient scale. Klepper and Simons study the same industry to argue that there was no specific innovation behind the shakeout.*

Jovanovic, Boyan, and Glenn MacDonald (1994): “The life cycle of a competitive industry.” *Journal of Political Economy*, **102**:322–47.

Klepper, Steven, and Simons, Kenneth L. (2000): “The making of an oligopoly: Firm survival and technological change in the evolution of the U.S. tire industry.” *Journal of Political Economy*, **108**:728–60.

#### Supplementary readings

French, Michael (1986): “Structural change and competition in the United States tire industry.” *Business History Review*, **60**(1):28-54

Gort, Michael, and Steven Klepper (1982): “Time paths in the diffusion of product innovations.” *Economic Journal*, **92**:630-53.

Horvath, Michael, Fabiano Schivardi, and Michael Woywode (2003): “On industry life-cycles: Delay, entry, and shakeout in beer brewing.” *International Journal of Industrial Organization*, **19**(7):1023-1052.

Jovanovic, Boyan, and Chung-Yi Tse (2006): “Creative destruction in industries.” NBER working paper no. 12520.

Klepper, Steven (1996): “Entry, exit, growth, and innovation over the product life cycle.” *American Economic Review*, **86**(3):562-583.

Utterback, James, and Fernando Suarez (1993): “Innovation, competition, and industry structure.” *Research Policy*, **22**(1):1-21.

#### **Weeks 15 and 16. Student Presentations**

## ECO 2023 Principles of Microeconomics

### Introduction

When I was asked to teach Principles of Microeconomics, my first instinct was to get copies of all the Principles textbooks that I could lay my hands on. So I did. And I didn't enjoy them: they sent me to sleep. Don't get me wrong, some of them are very good at what they do. But I didn't really like what they set out to do.

You see, Principles textbooks teach a subject matter. In these books, microeconomics is the study of individual markets, firm behavior and consumer behavior; macroeconomics is the study of the economy as a whole. These books seemed to me to miss the point. Economics is not a subject matter. It is a way of thinking. It is a moral philosophy. And if everyone in the world thought like an economist, the world would be a much happier place.

Economics is a way of thinking about every aspect of life. Of course we want to know how Procter and Gamble chooses what to produce, how much to produce, and what price to sell at. Of course we want to understand how consumers decide what to buy, how much to buy, and what they are willing to pay. But the same tools that enable us to understand these issues, also enable us to understand

- Why celebrity endorsements work, even though we know they are being paid,
- How the police can persuade two suspects to squeal on each other,
- How safety belts in cars have increased the death toll on roads,
- Why your next boyfriend or girlfriend will be a disappointment,
- Whether you should leave the toilet seat up or down.

among many other questions of life.

Economists, unlike politicians, religious leaders, philosophers, and just about anyone else, have a clear moral philosophy. We employ a small but precise set of criteria by which we judge whether people's actions are good for themselves and good for others. We use exactly the same criteria to assess whether government's actions are good for society. Economists are precise about when we can use these criteria to state that one outcome is superior to another. Economists are equally precise about when two outcomes cannot be ranked, and we don't invent ad hoc philosophies to fill in the gaps.

My job is to get you to think like an economist. If I succeed, you will be a smarter, happier, and more moral person, and the world will be a better place. If I fail, you can continue your business studies program none the wiser.

### Textbooks

Thompson, Peter (2005): Principles of Microeconomics. Manuscript, Florida International

University.

The text is available on this web site, and can be printed chapter by chapter in each section.

The following slim book is recommended:

Steven Landsburg (1995): *Armchair Economist: Economics And Everyday Experience* (paperback; approx. \$11 from Amazon).

Text chapter for this section

Thompson, Peter (2005): Introduction. Manuscript, Florida International University.

Transparencies

In the past I made Powerpoint slides for this course. Students objected that with slides the lectures went too fast, so I now use old fashioned chalk. I have left the slides available, but note that they are in parts out of date. The slides for this section can be downloaded here.

Class Attendance and Exams

Class meets Tuesdays and Thursdays from 3:30pm to 4:45pm in GL 100B.

My job is to make class attendance worthwhile and interesting. It's your decision whether or not to attend. But I have an incentive scheme. There will be four open-book in-class exams. The dates will not necessarily be announced in advance. The best two of your in-class exams will account for 50%, or the best three will account for 75%, of the grade, depending on what you decide to do about the final.

Two versions of the final exam will be offered. Both are 1.25 hours in duration, both are comprehensive and open-book. The first version will be given in the final class period, Thursday, 17 April. The second version will be given during exam week. Here is how they will be scored:

1) If you only show up to take the first final exam, that will count for 25% of the grade, and your best three mid terms will count for 75% of the grade.

2) If you only show up to take the second final exam, that will count for 25% of the grade, and your best three mid terms will count for 75% of the grade.

3) If you take both final exams, the total score will count for 50% of your grade and the best

two mid terms will count for 50%.

It is your choice what you do. Your optimal choice is an interesting economic problem, and by the end of the semester you will have the tools to solve it yourself. But here is the deal: I will not discuss the answers in general or your answers to, or performance in, the first exam before the second exam has been given.

So you can get a clear picture of what these exams are like. Here is a copy of 2005's first mid-term exam, and here is a copy of 2005's final exam.

No make-ups on the in-class exams will be permitted. If health or other events prevent you from taking an exam, you must contact CAS's Assistant Dean for Student Affairs. I will only respond to requests for a make-up received directly from the Dean's office.

### Grading

I am frequently asked whether I curve the exam scores. As I have not announced how many points you must get for an A, etc., this is a meaningless question. What many of you really want to know is how tough a letter grader I am. The answer is that I'm about average for FIU. [Click here](#) for a graph of the grade distribution I gave out in Spring 2005. It is quite likely that the distribution will be quite similar this year.

### Problem Sets

Most of the sections of this course have short problem sets, which can be found at the end of each chapter in the lecture notes. You are expected to complete these in the same week that we cover the material. However, I will not be collecting problem sets, and I will not be grading them. You may meet with me or the TA to discuss if your answers are on the right track. There is an important incentive for you to stay on top of this material: the exams will consist largely of close variations of these questions. If you do not seriously attempt the problem sets in a timely fashion, you will almost certainly fail the course. On the other hand, if you take the problem sets seriously, you will likely get a very good grade.

### Office Hours

I am available after 1pm every day.