Econ 350
L. Primeaux

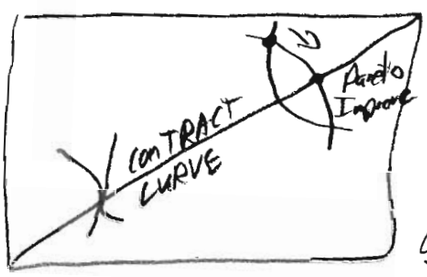
PART A — MIDTERM → W 2012

1) SIZE has INCREASED
ie: Gov. Ex 38% of GDP in 2006

2)

WHITE	RED
① Low Taxes	① High Taxes
② No Healthcare	② Healthcare
③ No Social Services	③ Social Services
④ High Tuition	④ Low Tuition

3)



Pareto Improvement - trade that makes at least 1 person better off & no one worse off

Contract Curve - all possible Pareto Efficient points

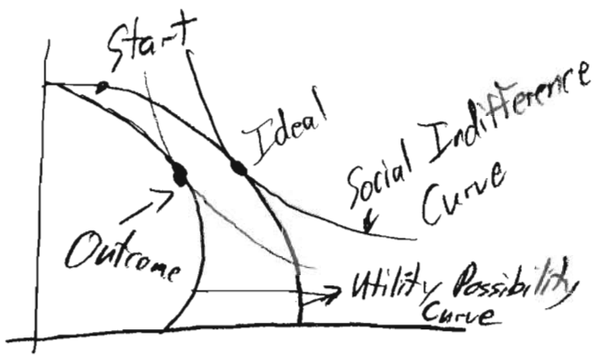
4)

	WHITE	RED
① Good Distribution?	No ↓	Yes ↓
② Enhance Efficiency?		
③ Reasonable Cost?		

5)

WHITE	RED
① Altruism too small	① Borrowing → Tax later
② Social Stability	② Print $ → Inflation Tax
③ Provide poverty insurance	③ Conscription → Inefficient
④ Uphold basic human rights	④ Gov. Fees → Exclusion costly OR Can't charge 4 welfare

6)



→ Funding redistribution through distortionary taxes curves UPC inward

→ Increasing income redistribution decreases efficiency

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7) WHITE: Rival - once 1 person consumes it, no other can consume it

Nonexcludable - costly or impossible to prevent someone from consuming it

ie: 1st place in line, scenic lookout

RED: Nonrival - once 1 person consumes it, so can another

Excludable - possible to prevent someone from consuming

ie: Big park w/a gate

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8) WHITE: Assumed: $MC = \Sigma MB$

Actual: $1.32MC > \Sigma MB$,

Therefore fewer paintings $\Rightarrow 1.32MC = \Sigma MB$

RED: Assumed: $MC = \Sigma MB$

Actual: $0.67MC < \Sigma MB$

Therefore more paintings $\Rightarrow 0.67MC = \Sigma MB$

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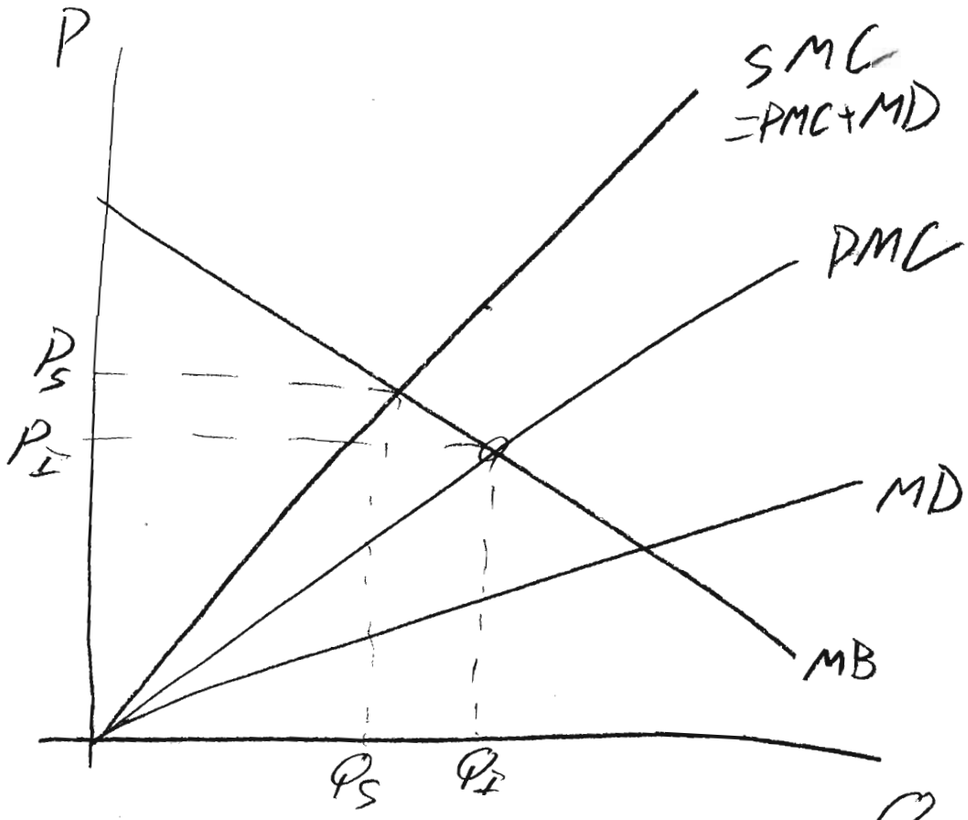
9)



Individual: PMC = MB ⇒ consumes @ Q_I, P_I
Society: SMC = MB ⇒ prefers Q_S, P_S
OVERCONSUME ($Q_I > Q_S$)

10) WHITE

1) Coase Theorem - Give property rights to someone affected by externality
2) Merger - Merge agents affected into 1 agent
3) Social Conventions
ie: Golden Rule

RED

1) Tax
2) Subsidy
3) Create a market
4) Regulation

First Fundamental Theorem of Welfare Economics:

IF

① Consumers + Producers have no market power

+

② A market exists for every commodity

Then

Resource Allocation is Pareto Efficient

Failure of ① ⇒ **Market Power**
- (ie) Monopolies, Oligopolies, Monopolistic Competition

Failure of ② ⇒ **Insurance Failure**
- (a) **Adverse Selection**
  - → Only risky buy insurance
    - → insurance market fails (ie: Healthcare)
- (b) **Moral Hazard**
  - → Insured are more likely to act "risky" + increase claims
    - → insurance market fails

⇒ **Externalities**
- → No "market" for externality effects (ie: clean air) → inefficiency

⇒ **Public Good**
- → Free-Riding causes UNDERPROVISION

All □'s call for government intervention

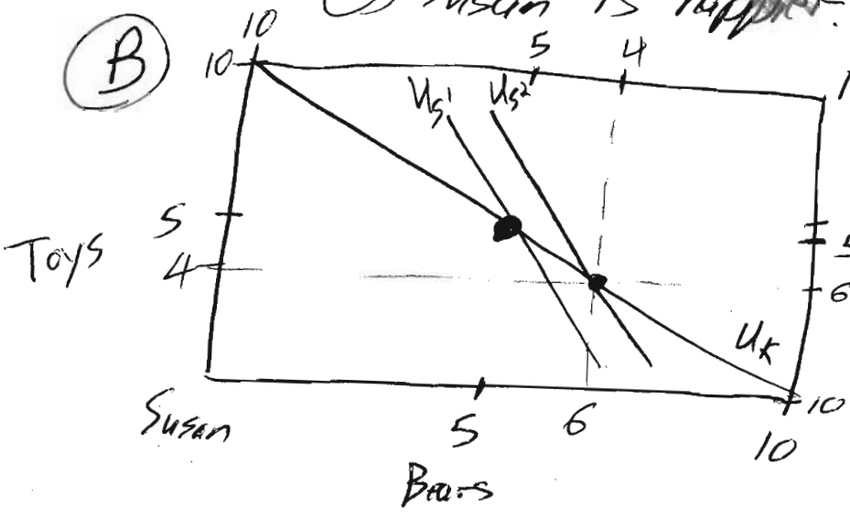
(A) Yes. Pareto improvement - one person is made better off w/o harming anyone else.

(ie) If Susan gives up 1 toy for 1 bear....

(i) Kaytelyn is equally happy

(ii) Susan is happier.

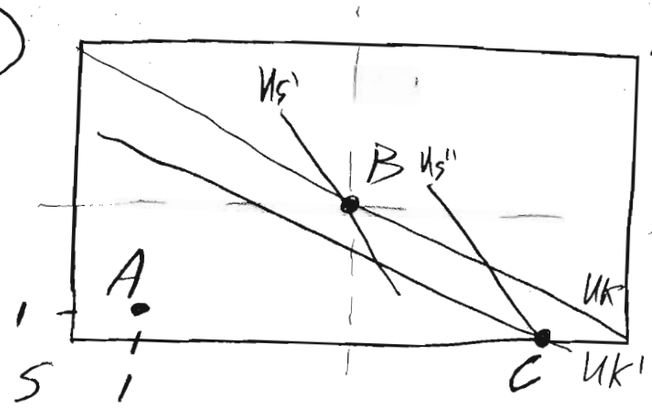
(B)



→ U_S increases

→ U_K remains constant

(C)



Second Fundamental Theorem of Welfare Economics:

→ Society can achieve ANY Pareto Efficient Allocation by changing initial endowments + allowing trade

A - initial allocation

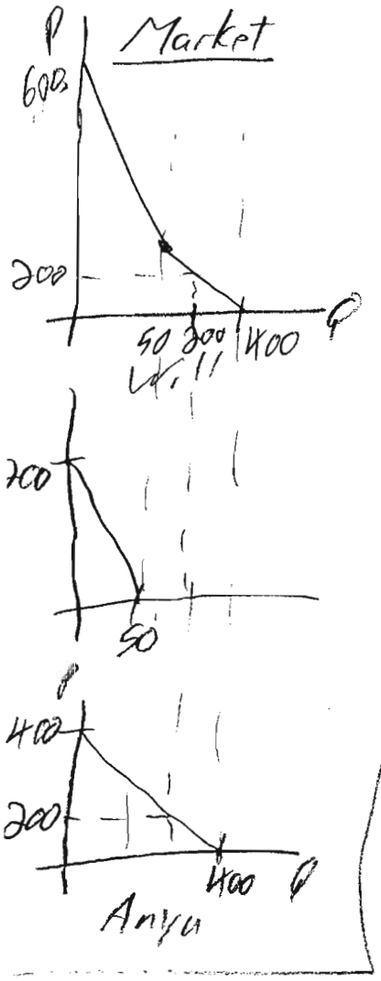
B - new allocation

C - Final allocation (example)

PART B

Econ 350 MT
L. Priemaza-Will
Blue

③ Public Good → Vertical Summation



Will: $P = 200 - 4Q$

Anya: $P = 400 - Q$

Market $= P^W + P^A$

$$P^M = \begin{cases} 600 - 5Q, & \text{if } Q < 50 \\ 400 - Q, & \text{if } Q \geq 50 \end{cases}$$

At equilibrium $P^D = P^S$

ⓐ $600 - 5Q = Q$

$100 = Q$

$100 > 50$ ✗ No

ⓑ $400 - Q = Q$

$200 = Q$

$200 > 50$ ✓ Yes

At $Q = 200$,

Will

$P = 200 - 4Q$

$= 200 - 200(4)$

$= 600 - 0$

Anya

$P = 400 - Q$

$= 400 - 200$

$P^A = 200$

$P^M = P^W + P^A$

$= 0 + 200 = 200$

PART B

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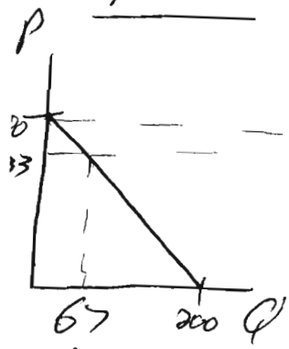
Private Goods ⇒ Horizontal Summation

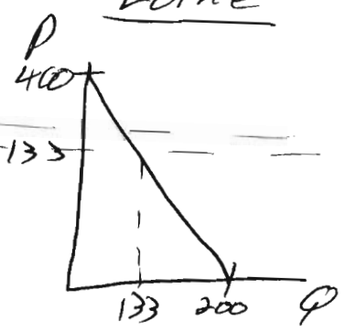
Anna



$P = 200 - Q$

$Q = 200 - P$

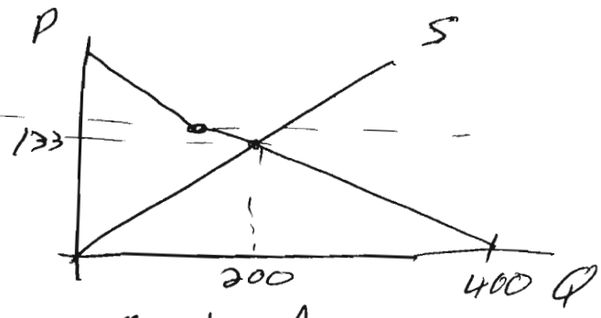
Lorne



$P = 400 - 2Q$

$Q = 200 - P/2$

Market



$Q^m = Q^L + Q^A$

$$P = \begin{cases} 400 - 2Q, & Q < 100 \\ \frac{800}{3} - \frac{2}{3}Q, & Q \geq 100 \end{cases}$$

∈ OR ⇒

$$Q = \begin{cases} 200 - P/2 & P > 200 \\ 400 - 1.5P & P \leq 200 \end{cases}$$

At equilibrium, $Q^S = Q^D$

ⓐ $1.5P = 200 - P/2$

$2P = 200$

$P = 100$

✗ No, $100 < 200$

ⓑ $1.5P = 400 - 1.5P$

$3P = 400$

$P = \$133$

✓ Yes, $133 < 200$

At $P = \$133$

ANNA

$Q^A = 200 - P$

$= 200 - 133$

$Q^A = 67$

LORNE

$Q^L = 200 - P/2$

$= 200 - 133/2$

$Q^L = 133$

Market

$Q = 400 - 1.5P$

$= 400 - 1.5(133)$

$Q^m = 200$

$Q^m = Q^L + Q^A = 200$