Final Exam
(100 points)

(10 pts)   1. What is the significance of the Arrow Possibility Theorem and its conditions? Identify and describe two of these conditions.

(12 pts)   2. What are secondary economic effects? Why is it okay to count them as welfare effects in some circumstances but not in others?

(13 pts)   3. One theoretical solution to the market failure induced by a nonrival good is to institute a specific style of prices. What is this style? What is unique about it? How are such prices established, that is, what information is needed and how would you use this information to set prices?

(15 pts)   4. Potential Pareto criteria are normatively challenging approaches to social decision making because (a) they are additive and (b) they monetarize effects on people and businesses. Discuss the major normative features of these two properties.

(20 pts)   5. Discuss what economists fully mean when they use the phrase "Willig results" (WR). Include in your discussion: (a) full theoretical background for the issue(s) addressed by WR, (b) the implications of WR for applied welfare analysis, and (c) whether/why you believe the WR are a crucially important contribution.

(30 pts)   6. In a two-good, single-period world where both goods are priced, a consumer is able to buy as much of good 1 (x_1) as she likes, but the availability of the second good (x_2) is limited by government controls. The current situation is that p_1=$4 and p_2=$2 and the consumer has an income (M) which is fixed at $400. Each consumer is allowed to purchase no more than 50 units of x_2. The consumer's perferences are fully accounted for in her indirect utility function which is given here:

$$v = \frac{1}{4}p_1^{-0.5}p_2^{-0.5}M .$$

The government is debating a proposal to reduce the x_2 "allowance" to 25 units due to the fact that consumption of this good causes more social harm (outside the consumer's scope of considerations) than previously thought.

a. Compute obtainable Hicksian measures of welfare change for this proposal.

b. Calculate the Marshallian measure of welfare change for this proposal.

c. Advise the decision-making body about your findings and the implications of these results for decision making.