UNIVERSITY OF WISCONSIN

Economics 101 – Spring 2007

Professor Brown

Problem Set 7
Due By March 14-16, 2007

Trade

1. On the island of Relaxia there is production and consumption of only one good, hammocks. The domestic demand curve for hammocks is P = 250 – 2Q. The domestic supply curve is P = 50 + 3Q. The world equilibrium price for hammocks is 140.

a. If Relaxia opens its shores to international trade what will happen? What happens to domestic production? Will Relaxia import or export hammocks, and how many will it import or export?

b. Now the leader of Relaxia imposes a tariff of 20 on each imported hammock. Holding other factors constant, what happens to domestic production. Will Relaxia import or export hammocks? How many?

Public Goods and Externalities: *Multiple Choice.*

2. An example of a good that is both rival and excludable is
   a. the defense services provided by a new stealth bomber.
   b. a pair of pants.
   c. beautiful sunset.
   d. an uncrowded theme park such as Walt Disney World.

3. Which of the following illustrates the concept of external benefit?
   a. Good weather increases the size of the wheat crop.
   b. A new pesticide increases the size of the wheat crop.
   c. A gardener enjoys her flowers.
   d. Neighbors enjoy the gardener's flowers.

4. The Coase Theorem states that:
   a. it is impossible to solve externality problems without the aid of government.
   b. it is impossible to solve externality problems with the aid of government
   c. efficient outcomes can be accomplished by private parties, even when externalities are present, as long as there are no bargaining costs.

d. there is a cost to negotiating externalities.
e. the government cannot solve externality problems without the intervention of private parties

5. Positive externalities cause the market to trade a quantity:
    a. smaller than the optimal quantity
    b. greater than the optimal quantity
    c. that can be greater or smaller than the optimal quantity
    d. that is exactly the optimal quantity

6. If a market has a negative externality, buyers and sellers won't trade the optimal quantity because
    a. The government fails to provide markets with all the information needed for an efficient outcome
    b. Producers fail to consider the external benefit in their decision making process.
    c. Producers fail to consider the external cost in their decision making process.
    d. They will trade the optimal quantity

<u>Public Goods and Externalities:</u>

7. Suppose the demand for widgets is given by P = 100- Q and the supply curve is P = Q. The production of widgets creates a negative externality of $5 per unit.
    a. What quantity of widgets will be produced if the government does not intervene?
    b. What's the socially optimal quantity of widgets?
    c. Suppose the government wants to impose a tax on producers to get the market to trade the socially optimal quantity of widgets. How much, per unit, should the tax be?
    d. What other methods could the government use to get the market to trade the socially optimal quantity?