

This review sheet is intended to cover everything that could be on the exam; however, it is possible that I will have accidentally left something off. You are still responsible for everything in the chapters covered except anything that I explicitly say you are not responsible for. Therefore, if I left something off of this sheet, it can still be on the exam. There will be no multiple-choice questions. Most of the questions will be like the ones in the homework assignments, and possibly a few definition questions, but I am more likely to ask questions that make you use the definitions rather than recite them. I will probably ask one of the questions from the book at the end of the chapters.

The review session will be at a time to be determined, probably Thurs. 4/28 in the Richardson 110.

The review sheet for the final will be forthcoming.

Chapter 16.3 - 16.7: How do we get the **utility possibilities frontier** from the Edgeworth Box? What is meant by a **social welfare function**? What are the advantages and disadvantages of the four social welfare functions, a.k.a. **views of equity**? How can we tell if we have **technical efficiency** and how does it relate to the **MRTS**? What is the **PPF**? Why does it take that shape and how do we find its slope and how does that relate to the **MRT**? How do we tell if we are producing and consuming efficiently? How does the **MRS** relate to this question? Be able to use the PPF diagram to prove that trade increases both countries' utility. How do we find **comparative advantage** and **absolute advantage**? Which determines trade? What is the **law of comparative advantage**? Be able to use a numerical example to prove that both sides gain from trade. Hint: Make sure the new price is between the two **autarky** prices. The three efficiency conditions mentioned above are summarized nicely on Pages 611 and 612. Be able to explain how **market power**, **incomplete information**, **externalities**, and **public goods** cause **markets to fail**.

Chapter 17: Understand how **asymmetric information** can lead to the **lemons problem**. What is **adverse selection** and what are examples of it in insurance and credit markets? Understand the importance of **reputation** and **standardization** as a way to reduce the problem. Does Major League Baseball have a lemons problem? What is meant by **signaling**? Why and how is it done? Understand the graph on Page 626. How do **guarantees** and **warranties** help with signaling? What is **moral hazard**? Understand how it applies to the graph on Page 629 and to other contracts. What is meant by the **principal-agent problem**? How does executive pay relate to this problem? How does it relate to the repairs? Understand the problem on Page 637; however, do not worry about the complicated solution on the next page. (The book does not give enough information to allow you to come up a solution to a general problem.) Understand the efficiency wage diagram. (Note: This is not the efficiency wage diagram you will get in ECON 350.)

Chapter 18 - 18.2: Understand the graph of how **negative externalities** cause inefficiencies. What are **MSC** and **MEC**? Understand the graph of how **positive externalities** cause inefficiencies. What are **MSB** and **MEB**? How do we use MEC and **MCA** to determine the optimal level of pollution? How can **fees** and **standards** be used to achieve the desired result? What are the advantages of both? (Personally, I feel it is rare that standards are better because it gives no revenue to the government.) How can **tradeable emission permits** be used to reduce the problem? Understand the diagram and problem of getting the optimal amount of recycling.

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Non-graded Homework Assignment #8A to be reviewed with Assignment #8.

- 1) (15 points) Explain how giving a CEO a bonus based upon current price of the stock can cause problems.
- 2) (20 points) Draw the efficiency wage diagram. Explain why the non-shirking constraint slopes up. How does the diagram explain why the wage may be above the market wage?
- 3A) (20 points) Draw the S/D diagram for a product like gasoline which causes a negative externality. Prove that we do not get the efficient level of production.
- B) (20 points) Draw the MCA diagram for two firms with different costs of abatement. Use it to prove that fees are better than regulations.
- C) (10 points) Explain why tradeable permits and fees are effectively the same except for the government revenue.
- D) (15 points) The arguments given in the book as to whether a fee (tax) or a standard is better relies on static analysis. Explain which is better for the long run. Why is that true?