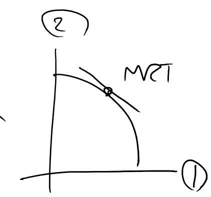
Tuesday, February 09, 2016 11:17 AM

WEEK 4 (09.02.16)

- LAST WEEK, **WE STUDIED** THE FIRST THEOREM OF FUNDAMENTAL WELFARE ECONOMICS (FTFWE): COMPETITIVE MARKET LEADS TO A PARETO EFFICIENT OUTCOME. THE CONDITIONS WE DERIVED AND TRIED TO UNDERSTAND ITS INTUITION ARE...

$$\boxed{\begin{array}{ll} MRS^A_{12} = MRS^B_{12} & \text{— (1)} \\ MRTS^1_{LK} = MRTS^2_{LK} & \text{— (2)} \\ MRS^A_{12} = MRS^B_{12} = MRT & \text{— (3)} \end{array}}$$



PARETO EFFICIENCY CONDITIONS

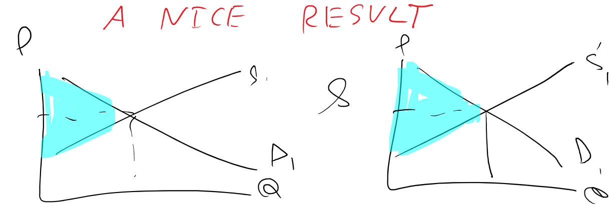
$$\underbrace{= \frac{P_1}{P_2} \qquad = \frac{P_1}{P_2} \qquad = \frac{MC_1}{MC_2}}$$

$$\left.\begin{array}{l} P_1 = MC_1 \\ P_2 = MC_2 \end{array}\right\}$$

WHEN FISH MARKET & COCONUT MARKET ARE COMPETITIVE!

⇓

IT WILL DELIVER A NICE RESULT



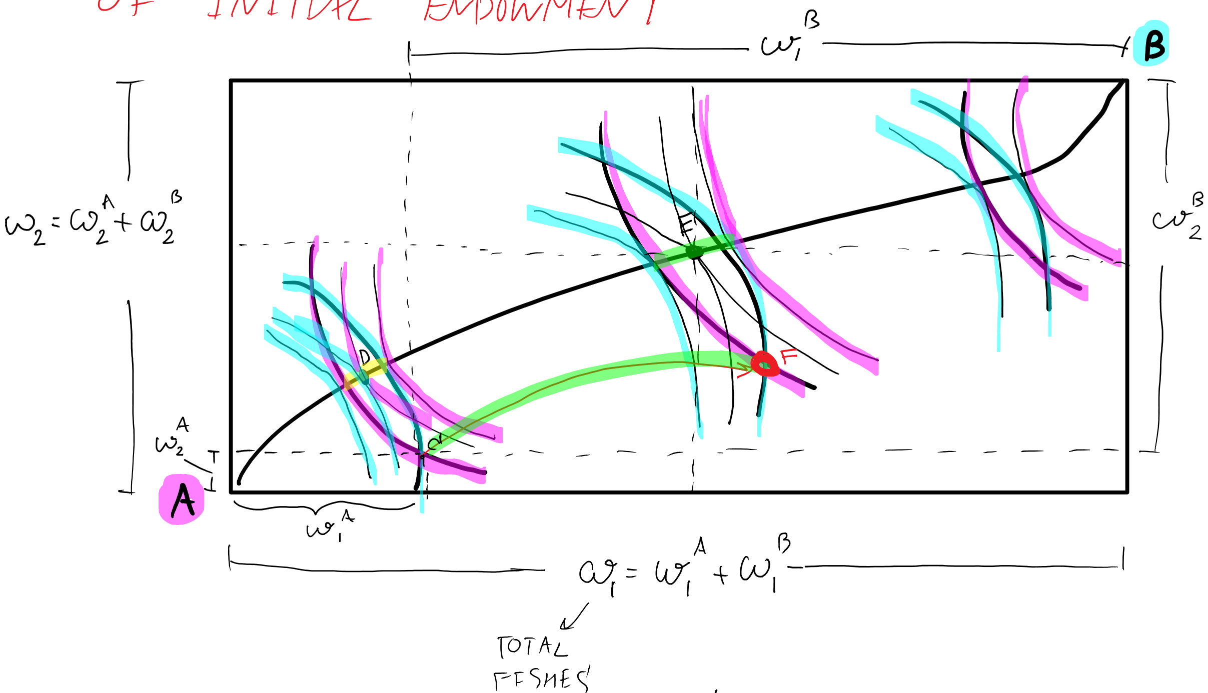
HOWEVER, EFFICIENCY IS NOT THE ONLY ONE CONCERN IN ECONOMIC SCIENCE. ECONOMISTS ALSO CARE ABOUT

EQUITY (OR FAIRNESS) → DISTRIBUTION OF THE PIE.

THIS LEADS TO THE SECOND THEOREM OF FUNDAMENTAL WELFARE ECONOMICS (STFWE) ... LET'S SEE:

2ND THEOREM SAID " ANY PARETO EFFICIENT ALLOCATION CAN BE ACHEIVED WHEN WE MAKE A SUITABLE REARRANGMENT OF INITIAL ENDOWMENT "

OF INITIAL ENDOWMENT"



① IF WE START AT ALLOCATION C', WE WILL END UP WITH ANY ALLOCATION ON THE CORE. SUPPOSE, WE END UP AT $\boxed{\text{POINT D.}}$ → PARETO OPTIMAL ALLOCATION? → YES!

→ IS IT FAIR? → MAY BE NOT. (WHY?)

B/C U^B IS A LOT GREATER THAN U^A!

IF WE WANT TO ATTAIN E IN WHICH A POLICY MAKER VIEWS AS "MORE-EQUAL-UTILITY" ALLOCATION, THEN WHAT HE CAN DO IS "REARRANGE" THE INITIAL ENDOWMENT FROM C TO F AND LET A AND B TRADE FREELY. E CAN BE OBTAINED.

THE REARRANGEMENT FROM C' TO F CAN BE DONE BY TAXES AND TRANSFERS/SUBSIDIES.

2ND THEOREM GIVES AN IMPORTANT ROLE OF GOVERNMENT INTERVENTION.

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NOW, WE DEPART FROM "MARKET EFFICIENCY" TO "MARKET INEFFICIENCY" (MARKET FAILURE)

- MONOPOLY POWER
- EXTERNALITY
- PROVISION OF PUBLIC GOODS
- ASYMMETRIC INFORMATION

PUBLIC GOODS

READ: ROSEN, CH. 4

PUBLIC GOODS ARE GOODS W/ 2 IMPORTANT CHARACTERISTICS:

① NONRIVALNESS IN CONSUMPTION: FOR A GIVEN QUANTITY OF THE GOOD, IF MR. A IS CURRENTLY CONSUMING IT AND MR. B COMES TO CONSUME THE GOOD, UTILITY OF MR A DOES NOT AFFECTED BY THE ARRIVAL OF MR. B.

EX: TV SIGNAL TRANSMISSION HAS THIS PROPERTY

② NONEXCLUDABILITY: ONCE THE GOOD IS PRODUCED AND PROVIDED, ONE CANNOT PREVENT THE OTHER TO ENJOY THE BENEFIT OF THE GOOD. (OR THE EXCLUSION IS VERY VERY COSTLY TO DO)

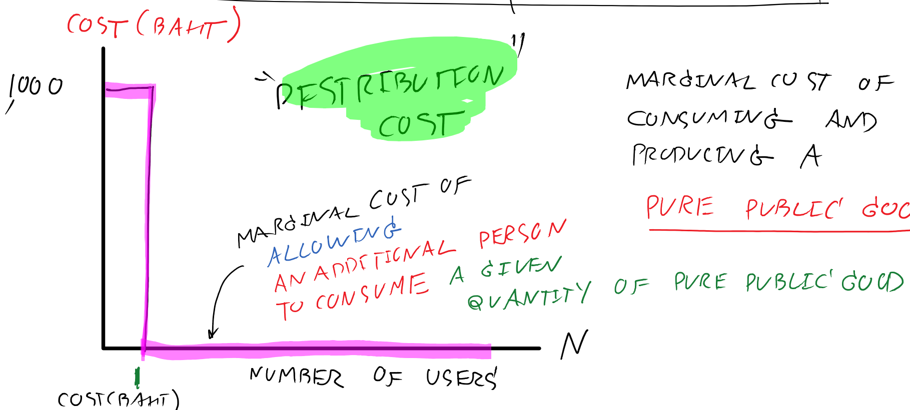
EX: NATIONAL DEFENSE, DAM, NATIONAL MUSEUM } HAVE THIS PROPERTY

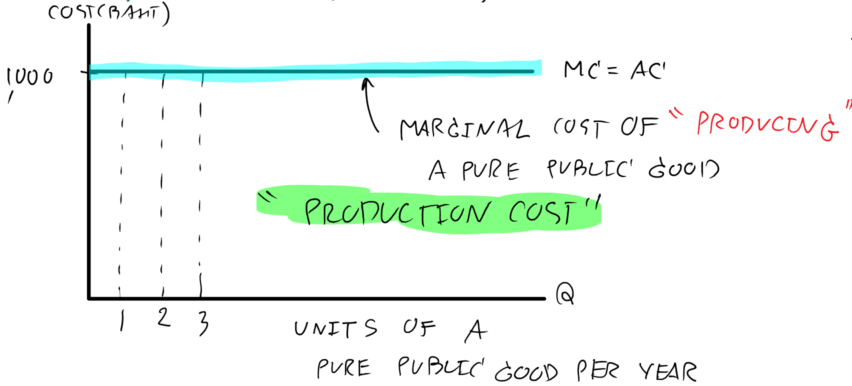
LUMPINI PARK

RIVAL \ EXCLUDABLE	YES	NO
YES	PURE PRIVATE GOOD WE HAVE A CLEAR ABILITY TO EXCLUDE AND RIVALRY FOR BENEFITS	CONGESTIBLE PUBLIC GOODS EX: FISHES IN NORTH SEA, COMMON RESOURCES
NO	• EXPRESS WAY DURING NON-RUSH HOURS • CABLE TV PRICE - EXCLUDABLE	PURE PUBLIC GOOD EX: NATIONAL DEFENSE

NO	DURING NON-RUSH HOURS • CABLE TV PRICE-EXCLUDABLE PUBLIC GOODS	Ex: NATIONAL DEFENSE

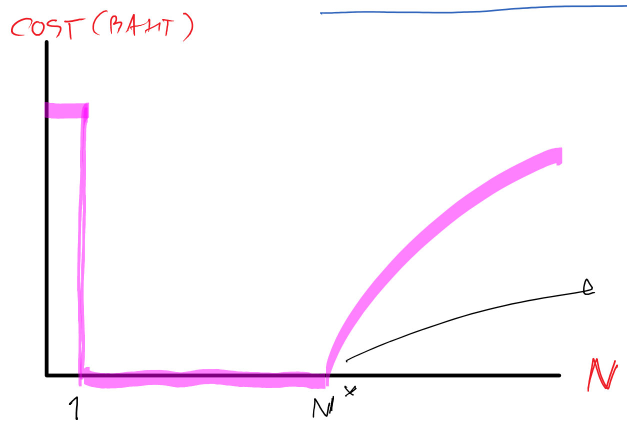
MARGINAL COST OF CONSUMING AND PRODUCING A PURE PUBLIC GOOD





→ ONCE THE GIVEN QUANTITY OF A PURE PUBLIC GOOD IS MADE AVAILABLE, MC OF "ALLOWING" AN ADDITIONAL USER TO CONSUME THE GOOD = 0 !

HOW ABOUT "COSTESTIBLE PUBLIC GOODS"?

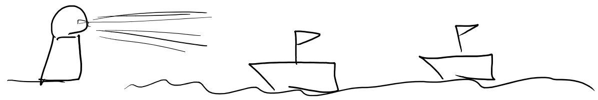


BEYOND N^*, MC OF ALLOWING MORE USERS TO CONSUME THE GIVEN AMOUNT OF THE GOOD STARTS TO RISE !

SOME REMARKS ABOUT PUBLIC GOODS

1. EVENTHOUGH EVERYONE CONSUME THE SAME AMOUNT OF PUBLIC GOOD, BUT IT IS NOT NECESSARY THAT EVERYONE WILL "VALUE" IT EQUALLY.
2. CLASSIFICATION AS A PUBLIC GOOD IS NOT AN ABSOUTE, IT DEPENDS ON
   - MARKET CONDITIONS

– STATE OF TECHNOLOGY

EX LIGHTHOUSE 

B/F THE INTRODUCTION OF JAMMING DEVICE

"PURE PUBLIC GOOD" → A/F IMPURE PUBLIC GOOD

AS PROPERTY OF NONEXCLUDABILITY IS DESTROYED.

EX VIBHAVADI RANGSIT ROAD

AT 2 AM
- NON-EXCLUDABLE
- NON-RIVAL IN CONSUMPTION

DURING RUSH HOURS
- NON-EXCLUDABLE BUT RIVAL!

3 SOMETHING THAT ARE NOT CONVENTIONALLY THOUGH AS COMMODITIES HAVE PUBLIC GOOD CHARACTERISTICS.

EX: HONESTY, JUSTICE, FAIRNESS, SCIENTIFIC DISCOVERY.

4
- THE TITLE "PUBLIC" GOODS DO NOT NECESSARY MEAN THAT THEY HAVE TO BE PRODUCED BY "PUBLIC" SECTORS

  EX: CHUWIT PARK, FLYOVER BRIDGE → PRIVATELY PRODUCED PUBLIC GOODS

- THE TITLE "PRIVATE" GOODS DO NOT NECESSARY MEAN THAT THEY HAVE TO BE PRODUCED BY "PRIVATE" SECTORS

  EX: SKYTRAIN, PUBLIC HOSPITALS, PUBLIC UNIVERSITIES, PUBLIC SCHOOLS, GOVERNMENT BONDS — PUBLICLY PRODUCED PRIVATE GOODS