

Name and Student ID: _____

Due 8 Sep 2015. You can turn in these pages or another printed version.

General Comments: This assignment was your first and it's only worth 10 percent of your grade. The average was B- and several people lost points for being late. The most common mistake was FAILING to read/answer the question. Please be careful and clear when you write (did you print and correct your answers before turning in a second draft?) Remember that some questions are not "the same old stuff" – some of you wrote "typical" answers to questions I never asked.

1. (6 points) You go to a bar or restaurant with some other people. Explain when it's "appropriate" for one person to pay for everyone, everyone to split the bill evenly, or for everyone to pay their own bill (three situations). Make sure you discuss interpersonal utility ($u_i(x_1, x_j)$), one-shot vs repeated transactions (the Folk theorem), and free riding.

Solution: This is NOT a theory question. "You" means I want you to tell me what YOU'D do. Students lost points for failing to discuss all the concepts in one or more scenarios.

One pays for all: someone is rich (ability to pay), treating others/family (interpersonal U) or it's a rotation (repeated game) among friends.

Split the bill: either a repeated game or everyone's eating the same menu

Pay your own: one time meal, or unequal portions in a repeated setting. Least interpersonal

Free riders are allowed in one person pays and a problem in split the bill (one shot game).

Most people lost points for failure to discuss interpersonal U; unusual/illogical stories; failure to use interpersonal correctly (it means happiness at other's consumption); and/or misunderstanding Folk Theorem.

The FT results in cooperation BECAUSE the game is repeated. It doesn't CAUSE cooperation and cooperation doesn't CAUSE repetition. (Cooperation can facilitate repetition, but that's NOT the Folk Theorem. The FT applies to non cooperative games with strangers.)

2. (2 points) A "negative externality" from Mr. A's consumption of a *private good* means that some people (not Mr. A) are harmed. Give an example of such a negative externality, and explain how it may be reduced *without* Mr A consuming any less of the good.

Solution:

Example: A harms B with smoking. B can move away OR A can pay B for damages. Examples that raised prices are NOT valid for this question ("without consuming less") because Q_d falls.

3. (2 points) An “appropriation problem” from Mr. A’s consumption of a *common pool good* means that some people (not Mr. A) have less of that good to consume. Give an example of such a problem from your life experience and how it might be overcome, i.e., such that the appropriation problem goes away or affects everyone equally “fairly.”

Solution: Lots of greate examples (often of family meals).

Potential solutions: divide into shares (privatization), more food (public good) or rules on sharing/rotation (club good or CP situation rather than dilemma).