1. (4 points) Landsburg [page 196] says:

   > Enhanced competition, enforceable contracts, appropriate incentives, attention to consistency, and market forces generally serve us well, and I believe we should be ever on the lookout for new settings where we can employ them.
   >
   > There is nothing in economic theory to suggest that existing political institutions are even close to optimal, in any sense of the word. If the best policy proposal seems bizarre, it might be only because we are unused to seeing anything like the best policy proposal in action... there is no substitute for the daring experiment.

   Describe an LUC policy that should be changed because its costs exceed its benefits for the average student.

   Solution: Everyone got full credit on this question (a few examples were weak, but whatever), and I learned a lot. I will pass along some of these ideas, informally.

   The most commonly criticized policies were mandatory residency at AVB, which is (a) expensive, (b) boring-in-the-bubble, and (c) likely to increase communal sickness. Against these problems, there were the benefits of tighter bonding with others, due to proximity. I can see the advantage of this policy (assuming the rental fee is high due to costs instead of profiteering), but perhaps there's ground for allowing first/second-year students to live off campus in fraternities.[1] The other least-popular policy is mandatory attendance. Many students pointed out the redundancy of this policy when passing classes is important (as well as the hassle of coming to class when sick or tired). The benefit from this policy appears to be a higher chance of passing classes, which is important for LUC's cash flow from the government. It's more likely that this policy would be relaxed if students could be failed out of LUC (or charged more for staying more than three years), but this seems to be constrained by Leiden U. policies.

   Other critiques asked for more courses (requiring either more professors or more students per class), allowing exams retakes (seems better than requiring a student to take the whole class over, esp. if penalty fees could be charged), better spending from Fortuna (seems like students should have more votes on events to keep or kill), and foreign-student recruiting by alumni rather than staff (this may be easier when there are more LUC alumni).

2. (6 points) You wake up one morning in the People's Republic of Radioactive Spending (PRRS), where "plutos" made of plutonium are used as money. The leaders of PRRS have adopted this currency to stimulate the economy through spending. Assume that there are no banks and that all transactions (purchases of goods or services varying from apples to houses to haircuts to monthly salaries) must be paid in plutos. People can either choose to hold money (losing one hour of life per pluto held per day) or dump it into the commons, where anyone else can take plutos and use them to buy things.

   In your answers, compare the situation in PRRS to that in our world today.

(a) (1 point) How do interest rates function in PRRS?

Solution: Interest rates balance among people's different desires to spend money, i.e., spending now for goods versus saving now to get more goods later. A patient person is willing to lend money to someone less patient in a win-win exchange. The patient person wants to earn, say 5 percent per year, but the borrower is willing to pay 15 percent to have money now rather than wait a year. They are both happy with an interest rate of 10 percent. In PRRS, there is a penalty (death by radiation) for holding money, so interest rates are not just zero, but negative – people would have to be paid to borrow (hold) money. That means that people are always willing to lend money. Lending money is more attractive than lending goods, since, for example, you can hold a bicycle without dying. Cash is not king. Possessions (or debts) are.

(b) (1 point) How frequently would you want to be paid wages in PRRS?

Solution: It seems like you'd want to be paid frequently, so you could buy daily necessities (e.g., food). Large payments would have to be lent immediately (or dumped in the commons) if they were not going to kill you. Most answers for this question made sense, e.g., daily, a mix of frequent and occasional, large but exchange for debt.

(c) (2 points) How would you know someone is rich in PRRS?

Solution: Savings would be represented in debts from others. The richest person loans money to everyone but expects to get it back (if they are not dead). Possessions would also represent wealth, but it's hard to know how someone would, say, buy a house, except by making a promise to assign lots of loans made to others, or perhaps assigning their income to the seller of the home. Houses would probably be VERY small (or built by groups of people) as a means of reducing the risk that the buyer would stop paying the seller. A negative interest rate implies paying less and less over longer periods of time, which makes it VERY difficult to build (or pay for) large purchases. Small purchases (daily food, monthly rent) would replace car and home loans.

It's also interesting to measure wealth by age at death. Did someone die young because they were rich and held plutos or poor and paid to hold plutos? I'd guess that the rich would use their wealth to maximize their life at a *minimum* acceptable style. Some would live fast, die young.

(d) (1 point) Would prices for goods (food, bikes, rent, etc.) be *relatively* higher or lower in PRRS?

Solution: They would be relatively higher, since everyone would want to spend money on immediate consumption. Quantity supplied would increase, but not by so much, since labor would be expensive (why work more if you're going to die?) and capital hard to put into use.

(e) (1 point) Would the average citizen of PRRS be better off or worse off, in terms of consumption?

Solution: If we assume that capital dominates labor in today's world (or the rich the poor or the 1 percent the 99 percent), then the average person would be better off in terms of wealth, but higher prices might offset that benefit.