

Study Guide Part I: Sectors

Public Goods

Public Goods (Mankiw, Chapter 10)

Pure Public Goods

—— Political Definition, Economist Definition

Non-Excludable

Non-Rival

—— Congestible Public Goods

—— **HOW DO POLITICIANS/THE PUBLIC DEFINE PUBLIC GOODS, VS. HOW DO ECONOMISTS DO SO?**

The matrix given in class

—— Non-Rival, Non-excludable — a Public Good

—— Rival, Non-excludable — a ?????

—— Non-rival, Excludable — a ?????

—— Rival, Excludable — a ???????

Publicly provided private goods”

The “Tragedy of the Commons”

Sample Questions

Q. Why has the Relative Price of Shrimp dropped in Thailand, compared to the Relative price of Fish?

Q. Why are African Elephants at risk of extinction, but Asian Elephants are not?

Q. Common goods are overconsumed — explain why. Give an example of a common good that is currently being over-consumed.

Q. What is the economic justification for spending money on the BTS. Public Parks. Schools. National Defense. TOT.

~~Externalities (Mankiw Chapter 10)~~

~~Define an externality~~

- ~~_____ What is a Positive Externality~~
- ~~_____ What is a Negative Externality~~
- ~~_____ Give examples of both~~

~~How to deal with externalities~~

- ~~_____ Command and Control~~
- ~~_____ Regulation~~
- ~~_____ What can, and can't, be measured~~
- ~~_____ How to value that which can be measured~~
- ~~_____ The information problem with command and control~~
- ~~_____ Revenue, or the lack of~~

- ~~_____ Pigovian Tax~~
- ~~_____ Graph the optimal quantity of the good~~
- ~~_____ Why is this hard to actually quantify?~~
- ~~_____ **SERIOUSLY, why is this hard to quantify?**~~
- ~~_____ The political problem,~~
- ~~_____ Why are Pigovian taxes wealth transfers?~~

- ~~_____ Cap and Trade (tradeable permits)~~
- ~~_____ Be prepared to give me a numeric example of it~~
- ~~_____ Why/How does cap and trade work?~~
- ~~_____ Cap and trade as an "economically efficient" solution~~
- ~~_____ Why did it work well when first introduced~~
- ~~_____ Why has it worked less well?~~
- ~~_____ Hint: business figured something out...~~

~~Q. Why have externalities become more important over time (hint—urbanization)?~~

~~Q. What is a Pigovian Tax? Please draw a graph of one, explain why the government should impose a ?????? to achieve the socially optimal amount of ??????. What are the difficulty of this?~~

~~Q. If a college education leads students to be more educated, and that makes them more productive, will they earn more income? If so, why should the government subsidize it?~~

~~Q. In a cap and trade program, the government allocates permits (which can be sold/traded) based on current pollution. Why did this work well the first time, but lead to unanticipated results afterwards?~~

~~Q. What is the information problem that Government faces when trying to use command and control regulations to reduce pollution?~~

Banking and Insurance (pg. 609 – 614)

The banking industry

- Assets and Liabilities
- “lend long, borrow short”
- Loans, reserves, interest
- Liquidity crisis, insolvency
 - Run on the Bank
- Bankers as risk-averse, bankers as risk takers
- Herd Behavior
- Risk vs. Uncertainty
 - Determinants of risks.
- Inflation (see later parts)
- Determinates of the interest rate?
 - Inflation
 - Take able assets
 - Length of loan
 - Credit history

The Insurance industry

- Risk vs. uncertainty
 - Risk aversion
- The law of large numbers
- Covariance
- Moral Hazard
- Adverse Selection
 - Actuarial tables
- Insurance as a betting market
 - Re-insurance and global warming

What problem with insurance (if any) do each of the following deal with?

- Premiums
- Co-pays
- Liability limits
- Deductibles

Q. Why is a run on the bank an example of collective irrationality but individual rationality?

Q. How do insurers manage risk?

Q. Why are actuarial tables such a good source of data, and why are not make public?

Q. Why do bankers have an incentive to be very, very boring when the bank is doing well, and why do they have an incentive to get risky when it is doing poorly?

The monetary system Chapter 29 – 30 (esp pages 640-654)

Money as a
Medium of exchange
Unit of account
Store of value
Liquidity

Kinds of money
Commodity money (gold)
Fiat Money
 Currency and demand deposits
Where is all the currency?
 Dollarization, and international drug operations

Money growth and Inflation

You may skip the supply/demand for money (pgs 637 – 639) as I taught it differently, using good old

$MV = PT$
Starting page 640,

Inflation Tax (seignorage)
The Fischer effect (real vs. nominal interest rates)

The costs of inflation
 Shoe-leather costs
 Menu Costs
 Tax distortions
 Relative price changes misallocated resources
 High inflation is also variable inflation
 The damage to the financial system
After pg 365, you may skip
 The redistribution of wealth
 The wizard of oz

Q. Why does signorage require increasing amounts of inflation to purchase the same amount of “real” resources.

Q. How does inflation effect nominal wages, and real wages?

Q. Why are banks less likely to offer loans, and people less likely to take them, when the inflation rate is high (hint: the Fischer effect, but it is more than just that)

Social Security

The program
The Demographic Transition
Potential Solutions

Q. What are the 5 commonly listed potential solutions to Social Security? Why is each one either difficult or impossible? What are the 4 less common solutions?

Q. Governments can't get out of the financial problems social security has by killing old people, without killing a lot of them. Governments could get out of their financial problems associated with medicare (old age health insurance) by killing a small number of old people. Explain

Q. What is the demographic transition? Why has it impacted social security so hard? (hint: don't forget the baby boom).

Q. The Social Security System has 1.8 trillion in the Trust Fund. But the social security system has no savings. Explain.

Public Choice Economics

Why do people vote?

Is voting rational?

Voting interests, or tastes?

Be sure to be able to explain “the irrationality of voting”

Voting as an expression of self. Voting is a consumption good.

Spatial models of politics

The median voter hypothesis

First past the post voting

Party list voting

Why do elections have the structures they do?

Parties

Alienation

The median voter (vs. average desires)

Zero sum, positive sum, and negative sum

Politics as zero sum

Markets as positive sum

Negative advertising

~~Vote Cycling~~

~~Why don't elections always have a final outcome~~

~~Non-transitive preferences (incl. Rationality, group irrationality)~~

~~Vote systems (BAS students may skip this)~~

~~How different vote systems produce different outcomes~~

~~Different types of voting....~~

Sample Questions

Q. Why is it that more people vote in presidential elections, than in smaller local elections, and what does that say about people “rationally voting their interests”.

Q. What is the difference between an instrumental good and a consumption good? Why does voting seem to be a consumption good?

Q. Explain the concept of “rational ignorance”, and why it applies much more to voting than to markets.

Q. Why do politicians in first past the post voting go negative so easily, but then govern similar, while politicians in proportional voting systems are less likely to go negative, even though they are probably farther apart on policy.

Q. “The 1997 Thai Constitution was designed to create a Thaksin”. Explain

Q. Why does winner take all lead to two parties, and proportional representation leads to multiple parties?

~~*Q. What is Vote Cycling?*~~

Q. Markets are positive sum. Politics is often zero, or negative, sum. Explain