

Problem Set #3  
 ECNS 204  
 Due Monday, Sept. 14<sup>th</sup> by 10am  
 Submit to shared Dropbox folder or email to TA at [alectruax@gmail.com](mailto:alectruax@gmail.com)

\_\_\_\_\_ Name

1.) Cain and Fabricio have the following MV schedules for heads of cauliflower.

Q	MV (Cain)	MV (Fabricio)
1	10	12
2	9	10
3	8	8
4	7	7
5	6	5
6	5	2
7	4	1
8	2	0
9	1	0
10	.5	0
11	0	0

a.) Cain has an initial endowment of 0 heads of cauliflower and Fabricio has an initial endowment of 11 heads of cauliflower. How many heads of cauliflower will be exchanged and what are the gains from trade?

*Q = 6 units are traded*

$$\text{Gains from trade} = (10-0) + (9-0) + (8-0) + (7-0) + (6-1) + (5-2) = \$42$$

b.) Now suppose Cain has an initial endowment of 4 heads of cauliflower and Fabricio has an initial endowment of 9 heads of cauliflower. How many heads of cauliflower will be exchanged and what are the gains from trade?

*Q = 4 units are traded*

$$\text{Gains from trade} = (6-0) + (5-0) + (4-1) + (2-2) = \$14$$

2.) In a perfectly competitive market with many buyers and sellers, are the marginal values of all people trading equal? Explain why or why not.

*Yes, b/c all individuals in the market trade up to the point where MB=MC (i.e., P=MV) and all face the same price, then all will have the same MV in equilibrium. This does not, however, imply that everyone will buy or sell the same amount. NOTE: Grade this one harshly...it requires a precise answer to be sufficient.*

3.) "Prices to consumers could be reduced if the profits of the middlemen could be eliminated." Do you agree? What explains the general absence of truck farmers, who

bring their produce to urban centers for direct sale to consumers? (Silberberg and Ellis, Ch. 4, #10)

*Middlemen exist b/c they produce something of value. They lower the transaction costs and hence the prices of goods consumers desire. Eliminating the profits of the middlemen in markets unrestricted by legal barriers against trade would not be in the interest of consumers because this would result in more costly goods to consumers as more expensive means are employed to bring seller and buyer together. High transaction costs explain the general absence of "truck farmers." It is much cheaper for farmers to do what they do best, farming, and to pay middlemen to take their produce to retailers.*

- 4.) The purchase of ordinary goods and services in the market is often referred to as "voting with dollars." The analogy is not, in fact, terribly good. To begin with, our endowments of income are different, whereas our political endowments are equal – one vote each. Also, we all get the winner of an election, or the effects of some legislation, whether or not we voted for the winner or favored that bill. Lastly, citizens vote infrequently (as opposed to legislators). (Silberberg and Ellis, Ch. 4, #15)
- a.) What opportunities do individuals have for expressing the intensity of their preferences, in market versus political choices?  
*To express the intensity of their preferences, individuals make repeated purchases of goods in the market, but only vote once in the political area.*
- b.) How frequently do exchanges of votes (i.e., "You vote for my person/issue and I'll vote for yours.") take place among ordinary citizens relative to such trades among legislators?  
*Exchange of votes between ordinary citizens does not take place because there is no way to enforce the agreement with secret ballots. Such trades are quite frequent among legislators primarily because these agreements can be enforced by roll call voting.*
- c.) Why do legislators, in particular, engage in vote trading (i.e., "logrolling"). What enables them to do this more than ordinary citizens?  
*Legislators, in particular, engage in vote trading because their marginal values on issues differ among them. Open roll call voting enables legislators to exchange votes more than ordinary citizens*
- d.) Consider an issue that is mildly favored by a majority of voters, but strongly opposed by some minority. How would such an issue fare in legislature versus in a referendum to the voters?  
*In the legislature, the issue is likely not to pass, but in a referendum, it is likely to pass.*
- e.) Suppose some law is contemplated. Why is this something of an all-or-nothing choice for consumers, as opposed to ordinary market purchases?  
*A law is either passed or not; in the market place, individuals can choose not only whether or not they want to consume the good at all, but also precisely how much. If it were possible for individuals to purchase legislation in the market place, the amount of legislation passed would exceed the amount of legislation passed under the "all-or-nothing" choice because consumers would purchase legislation up to the*

*point where the marginal gains from the legislation equaled its cost. However, sometimes legislators add amendments to laws, forcing us to consume more of some program than we want, because they are able to give us an all or nothing choice.*