

Que1. As a businessman why should you care whether a particular good is a “public good” or a “private good”?

Ans1. **As a businessman, my prime concern is to make profit and keep providing better goods. Hence, I need to be aware of the characteristic of the good, i.e. whether it is public or private.**

Private goods have the properties of excludability and rival consumption. Excludability means that consumption of a good is restricted to certain people, who are willing to pay for the good. Rival consumption means that consumption of a good by one person decreases the quantity of the good available for consumption by others. Hence, only an individual who is willing to pay the price set by the seller can obtain it.

Public good are just opposite of private goods. The benefits derived from the provision of pure public goods cannot be confined to only those who have actually paid for it. This is known as the “free-rider” problem and it means that people have a temptation to consume without paying.

Que2. A year ago CNN reporting included a story about how two lanes of a multilane freeway are being converted into a pay toll road. For a fee, drivers now can drive on the less congested lanes and can travel at higher speeds than they could if they were in the regular non-pay lanes. What type of good (private or public) does this suggest is the “freeway”?

Ans2. **The story reported on CNN clearly suggests that ‘freeway’ is mixed good. It can neither be defined as a pure public good nor a pure private good. Two of many lanes are being converted into a pay toll road. Hence they have the Excludability and Rival characteristics. On the other hand, other lanes exhibit the public goods characteristics of non-excludability and non-rivalry.**

Que 3. Instead of our “like at least as much as” preference, consider a relation that is defined as “beats in a one-on-one election”. Call this relation the “majority rule relation”. Consider the small, three person society with preferences over potential Presidential candidates and determine the majority rule relation for each pair of candidates. Is this relation transitive?

Bob	Sally	Alice
Obama	Paul	Romney
Paul	Romney	Obama
Romney	Obama	Paul

In this table, the candidates are listed with the most preferred candidate at the top of each voter’s column.

Ans 3. **No, this relation is clearly not transitive. In fact, this is a counter example of transitivity. Transitivity relation means that “x at least as good as y and y at least as good as z implies x at least as good as z”. We can infer from the table that none of the three**

candidates can establish a majority and we cannot establish transitivity in this case. This is a cyclic process.

Que 4. In our treatment of consumers one thing you have probably noticed is that it always turns out that the consumers always spend all their money. Which of our assumptions about consumer preferences is responsible for this result? Does this result seem reasonable to you? Specifically, does it fit your personal budget/consumption situation?

Ans 4. **Monotonicity preference means that “More is better”. So clearly, monotonicity preference is responsible for this result as it can maximize the utility of consumers. However, in real world, this result does not seem reasonable because consumers’ spending is governed by a limited budget. We are not guaranteed of a future income, so spending everything is not wise. This situation can be best answered by ‘Convexity’ assumption that tells us that for any pair of bundles x & y , between which the consumer is indifferent, the convex combination of the two bundles is preferred to either x or y . Thus, consumers will buy bundle that lies on the straight line between them and not all of one. The straight line is the budget of the consumer, above which consumer cannot go.**

