Review Sheet #3

Chapter 11

1. Be able to define the terms negative externality (or external cost) positive externality (or external benefit).
2. If the production of a good results in a negative externality, will an efficient quantity of the good be produced? If a positive externality is created? Why not? Be able to show graphically.
3. What is the Coase theorem? Will the efficient level of output be produced no matter who is assigned property rights? What limits applicability of the Coase theorem in dealing with pollution?
4. How can taxes and subsidies be used to correct for externalities? (see chapter 14)
5. What is the command and control approach to correcting for externalities? What are the weaknesses of that approach?
6. How does a “cap and trade” system of permits work? What are the advantages of this type of system? (see chapter 14)
7. What is the tragedy of the commons?

Chapter 12

1. What is the “free rider problem”? Be able to give an example.
2. Be able to calculate the expected value of a gamble.
3. Be able to define the term “asymmetric information”?
4. What is the “lemons problem”? How can it reduce the quality of used cars for sale?
5. What is the “costly-to-fake principle”?
6. What is adverse selection? How could the combination of asymmetrical information and adverse selection result in a failure in the market for insurance?
7. What is statistical discrimination? Is it rational for firms to choose to practice statistical discrimination?

Chapter 13

1. What is the difference between an input (or factor) market and an output (or product) market? Be able to explain who are the buyers and who are the sellers in each market. Is the market for heating oil an input market, an output market, or potentially both? Explain.
2. What are the characteristics of a purely competitive labor market? Is the labor market for secretaries in Youngstown an example of a purely competitive labor market? Why or why not? What about the labor market for nurses? College faculty?
3. Be able to define the term derived demand.
4. Why are firms in a competitive labor market wage takers? What is a wage taker?
5. What does marginal revenue product measure? Why would we expect that MRP will begin to decline at some point?
6. What is the profit-maximizing level of employment? If MRP < W, what should the firm do? Be able to show the profit-maximizing level of employment graphically.

7. What is the value of marginal product (VMP)? When will VMP equal MRP and when will it differ? In what sense does a monopolist hire “too few” workers?

8. If the wage rate rises, would an individual want to work more or fewer hours? Explain using the terms income and substitution effect. Why can't we predict what will happen?

9. The total number of hours worked by all individuals in the economy is relatively insensitive to a change in the wage rate (supply is very inelastic). However, the supply curve to a specific labor market (such as the market for secretaries in Pittsburgh) is upward sloping. How do we reconcile these two facts?

10. How does the long-run labor supply curve differ from the short-run labor supply curve? Is the long-run curve more elastic or inelastic?

11. What is meant by the term compensating differentials? What are some examples of compensating differentials?

12. What are some barriers to entry into a labor market? How do barriers to entry affect the wages in a market?

13. Explain the difference between a craft union and industrial union. How do craft unions seek to increase wages? Show graphically. How do industrial unions seek to increase wages? How does wage-setting by industrial unions affect the wages of non-union workers?

14. What is the definition of labor market discrimination?

15. How does employer discrimination alter labor market outcomes? How will competition discourage employer discrimination? Will competition eliminate statistical discrimination?

16. What is meant by the term “human capital”? Be able to list different types of human capital.

17. What are “winner-take-all” labor markets?

18. What has happened to the distribution of income over the last 30 years? What are some of the explanations for the changes in the distribution of income?

19. What is meant by defining poverty in an absolute sense versus defining poverty in a relative sense? How is poverty defined in the United States?

20. Which groups have the highest rate of poverty? Why has the poverty rate of the elderly declined since the 1950’s?

21. What are the primary differences between Aid to Families with Dependent Children (AFDC, the original form of welfare) and Temporary Assistance to Needy Families (TANF)?

22. What is the Earned Income Tax Credit?

23. What does the research show regarding the minimum wage, employment, and poverty?

Chapter 15

1. What is a public good (as the term is used by economists)? What are the two key characteristics of a public good?

2. Will a competitive market provide an efficient level of output of a public good? What is the optimal level of output of a public good? Explain. Why would charging a user fee for a pure public good create a deadweight loss?
3. What is a “pure private good”? A “pure commons good”?
4. If the cost of providing a good is equally divided, will voting necessarily result in the optimal amount of production of the public good?
5. Be able to define the terms: median voter rule and political externality.
6. How does “pork barrel legislation” and “rent-seeking” create waste in the public sector?
7. Why might the imposition of user fees result in a deadweight loss?
8. Be able to define the following terms: head tax, regressive tax, proportional tax, progressive tax.
9. Is the income tax progress? What effect does it have on the distribution of income? Are sales taxes progressive?