

Section A: Multiple-choice Questions

1. D 2. A 3. D 4. A 5. D 6. B 7. B 8. D 9. D 10. B
 11. D 12. A 13. C 14. C 15. D 16. B 17. D 18. A 19. B 20. B
 21. D 22. B 23. D 24. D 25. B 26. A 27. D 28. D 29. B 30. D

Section B: Short Questions

- As far as the full cost approach to the law of demand is concerned, the concept of full cost incorporates the effects of relevant change in constraints. The assumption of 'other things being equal' is superfluous in the law of demand. If the law of demand is expressed in terms of the relationship between pecuniary price and quantity demanded, then the assumption is indispensable as the pecuniary price serves only one of the factors affecting quantity demanded.
- A proxy contains no information about consumer's preference which is embraced in the price mechanism. So it by itself fails to guide production and consumption. Instead, it relies on central agents' visible hand to command resources. In no way a proxy is linked to labour productivity.

As the marginal productivity theory ' $w = MP$ ' applies in the case of the price mechanism only, proxy, serving as a alternative to pricing signaling, is in conflict with the theory.

- Not definite. The equality of marginal value satisfying the Pareto condition holds only when the transaction costs are negligible. In the presence of transaction costs, even though there exists a discrepancy between marginal value, the corresponding resources allocation can still be claimed efficient as long as the discrepancy reflects the per unit full transaction cost.

In addition, if the postulate of diminishing marginal value does not hold, the equality of marginal value ensures the lowest total use value, rather than the highest value. There is no way to claim that the equality condition satisfies the Pareto condition.

- Economic rent is defined as the maximum amount that can be charged without affecting the way resources are used, and is adopted, in methodology, to explain competitive behavior. This concept helps define the equilibrium in different competitive contexts. Different competitive environments will have distinct constraints giving rise to economic rent, in turn resulting in diverse kinds and

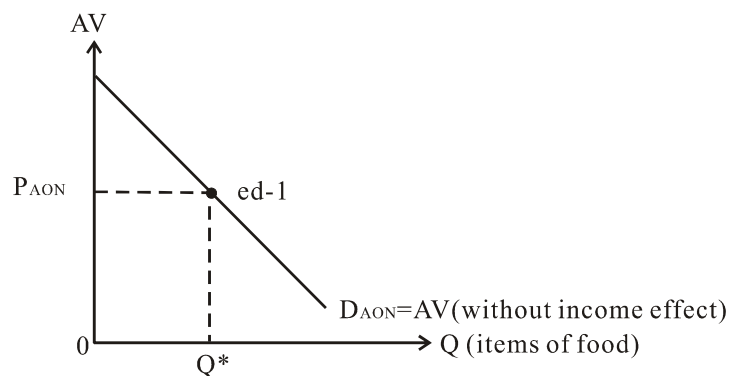
intensity of competition. The final equilibrium is characterized by zero economic rent, from which testable implication can be derived.

5. The invariant proposition of the Coase Theorem posits that with zero transaction costs and well-defined private property rights, the final resources allocation is identical and efficient regardless of whoever owns the private property rights initially. Its core states that private property right is prerequisite for efficient market operation.

The problem is the logical conflict between zero transaction costs and well-defined private property rights. Since the formation of institutional arrangements, afforded by a bundle of property rights, aims to minimize transaction costs and thereby maximize the net social gains from resources allocation, zero transaction costs leave no role for private property rights to play in resources allocation.

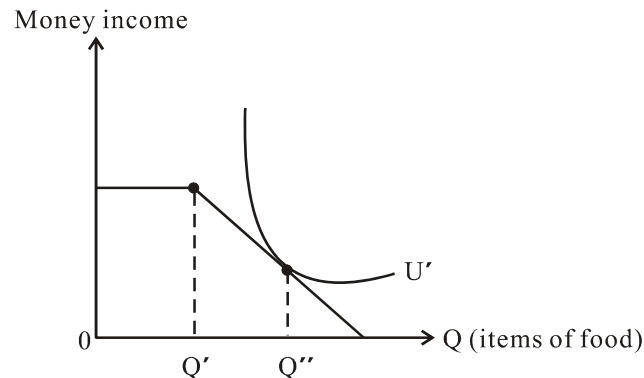
Section C: Application Questions

- 6a. The first part of pricing is an all-or-nothing pricing arrangement. The noodle stalls aim to maximize the total revenue which equal the total use value of a certain number combination times the number of customers. When more items of food are included in the first part of pricing, its lump-sum price will rise, resulting in fewer customers by the law of demand. However, this may not lead to a fall in total revenue, depending on demand elasticity. To maximize the total revenue, noodle stall will choose the point with unitary demand elasticity along the market all-or-nothing demand curve (i.e., the AV curve).



$$Q' = \text{number combination} = \frac{Q^*}{\text{number of customers}}$$

- 6b. When the customers are in more favor of the food, their indifference curves become steeper, thereby having higher MRS of every unit. As a result, they prefer extra items of foods apart from those included in the lump-sum pricing.



- 6c. The all-or-nothing pricing arrangement fails to guide resources allocation as its quantity is exogenously determined. Fortunately, the second part of constant marginal price can signal resources to the condition of $MV = MC$ where the Pareto condition is satisfied by virtue of the fact that consumers equate their marginal value with price ($P = MV$).
- 7a. If the minimum wage is based on a proxy such as working hours, this will simply raise the lump-sum cost of employing workers without raising their productivity. By adding this extra lump-sum employment cost to the given monitoring cost, employers will find the 'relative price' of high-quality monitoring lower. By the law of demand, employers will enforce more high-quality monitoring, thereby less frequent shirking.
- 7b. As employees are pressed to complete the products within a shorter period, product and service quality turns out poorer. In addition, employers will shift to those kinds of contracts that are more forceful on production time, such as piece-rate contract, the product quality further deteriorates.
- 7c. There involves a tremendous shift in kinds of contracts, resulting in substantial transaction costs. They are a kind of efficiency loss.

8. The 20% off is an economic rent from providing long-distance routes. Since long-distance routes save the time in touting for passengers of short-distance routes, the corresponding fall in gasoline and time costs generates extra revenue, a kind of economic rent.

In times of economic recession, taxi drivers take more time to canvass passengers. It makes more possible for economic rent from, and thereby price competition for, long-distance routes. This gets special-offer taxi cartels more prevalent.

9. It is caused by the lack of well-defined property rights to pollutants; otherwise, the external effects would be traded in the marketplace, and thereby compensated. In turn, this would result in no divergence between private and social costs, keeping the global warming to the optimal level. The ill-defined private property rights to pollutants are caused by substantial cost of defining and policing pollutants, and the cost of transacting these external effects.

If the international pacts are entitled to have genuine authority to direct the allocation pollutants, it can somehow reduce the cost of transacting external effects (but it surely cannot lower the cost of defining and policing pollutants), then it does work to limit the global warming (It is an application of the nature of firm).