

Economics 5250/6250
Fall 2010

Dr. Lozada
Midterm Exam

This exam has 33 points. There are six questions on the exam; you should work all of them. Half the questions are worth 5 points each and the other half are worth 6 points each.

Put your answers to the exam in a blue book or on blank sheets of paper. The figure for the exam appears after the questions.

Answer the questions using as much precision and detail as the time allows. Correct answers which are unsupported by explanations will not be awarded points. Therefore, even if you think something is “obvious,” do not omit it. If you omit anything, you will not get credit for it. You get credit for nothing which does not explicitly appear in your answer. If you have questions about the adequacy of an explanation of yours during the exam, ask me.

You have **1 hour and 5 minutes** (that is, until 12:55PM) to finish this test.

Answer all of the following questions.

1. **[6 points]** Often we have assumed society wishes to equate “Marginal External Cost” and “Marginal Net Private Benefit.” Why does such an assumption make sense? Include in your answer a discussion of “External Cost” and “Net Private Benefit” (note the last two phrases do not include the word “Marginal”).
2. **[5 points]** In class, we discussed how asymmetric information can cause “adverse selection” (if there are hidden “types”) or “moral hazard” (if there are hidden actions).
We also discussed how, if there is asymmetric information about the Marginal Net Private Benefit curve, Coasian bargaining can result in an outcome which is not socially optimal, due to the ability of one of the parties to make (empty) threats. Explain this analysis. As a small part of your answer, tell me whether this is a case of adverse selection or of moral hazard.
3. **[6 points]** What important economic result does Figure 1 illustrate? Use Figure 1 to prove the result (at least in the special case illustrated by the figure).
4. **[6 points]** Why do we expect Willingness to Pay to usually not equal Willingness to Accept? It’s enough to illustrate your answer with one graph showing either a potential gain of utility or a potential loss of utility; you do not have to illustrate both cases.
5. **[5 points]** What is the “starting point bias” present in (some) contingent valuation analyses?
6. **[5 points]** Some critics of Nicholas Stern’s economic analysis of global warming say the discount rate he used was too low. If he had used a higher discount rate, what might have changed in his analysis? Why?

