Practical Session I

Redistribution and fair allocation

1. Since the free market (competitive) equilibrium maximizes social efficiency, why would the government ever intervene in an economy?

2. Consider an income guarantee program with an income guarantee of €6,000 and a benefit reduction rate of 50%. A person can work up to 2,000 hours per year at €8 per hour.

   a. Draw the person's budget constraint with the income guarantee. Suppose that the income guarantee rises to €9,000 but with a 75% reduction rate.
   b. Draw the new budget constraint.
   c. Which of these two income guarantee programs is more likely to discourage work? Explain.

3. Consider a free market with demand equal to $Q = 50 - 0.5P$ and supply equal to $Q = P - 10$.

   a. What is the value of consumer surplus? What is the value of producer surplus?
   b. Now the government imposes a €15 per unit tax, to be paid by suppliers. What is the consumer surplus now? What is the producer surplus? Why is there a deadweight loss associated with the tax, and what is the size of this loss?

4. Governments offer both cash assistance and in-kind benefits, such as payments that must be spent on food or housing. Will recipients be indifferent between receiving cash versus in kind benefits with the same monetary values? Use indifference curve analysis to show the circumstances in which individuals would be indifferent and situations in which the form of the benefits would make a difference to them.