

ECON 107

Quiz 5

This quiz will last 10 minutes.

1. (6 points) **Honor Statement:** Please read and sign the following statement:

I promise that my answers to this test are based on my own work without reference to any notes, books, or the assistance of any other person. I will also neither help others nor use a calculator or other electronic aid for calculation.

Name and Surname: _____

Student ID: _____

Signature: _____

2. (5 points) What is a *sunk cost*? What is the *sunk cost fallacy*?

Solution 1 A sunk cost is a non-recoverable cost. Essentially it is "burnt money" the classic example is a ship at the bottom of a lake, river, or ocean. Like the Titanic it might be worth money if it could be gotten out, but the cost of raising it would be much more than the amount you could get for it.

The sunk cost fallacy is allowing sunk costs to affect your decisions. My favorite example of this is someone who has bought concert tickets and says "I have to go, I bought the tickets." Please, yes the bar for going is lower, but you "have to"? In what reality?

3. (3 points) Define one of the axioms of preferences and explain what it rules out.

Solution 2 I am going to define them all, they of course only have to do one.

(a) Reflexivity: $A \succsim A$ or "A is always at least as good as A" this requires that preferences are only over outcomes, not process or the set of possible choices.

(b) Transitivity: If $A \succsim B$ and $B \succsim C$ then $A \succsim C$, and this rules out decision cycles.

(c) Completeness: for every A and B either $A \succsim B$ or $B \succsim A$. This requires that we can always compare everything.

4. (3 points) List one of the inefficiencies in the provision of Club goods and explain what it is.

Solution 3 *Like before I will do both.*

(a) *Underprovision—since the provider will maximize their revenue and this will be much less than social welfare they will under provide club goods.*

(b) *Exclusion—in order to make revenue, the provider has to charge a positive price. On the other hand, maximizing welfare would require that anyone who wants to consume it should. Thus those with a low value for the good will be not allowed to consume it when they should*

5. (3 points) Standard feedback questions:

(a) Out of ten, my level of comprehension of the material covered this week is:

(b) My favorite topic of the week was:

(c) The topic I understood the least this week was: