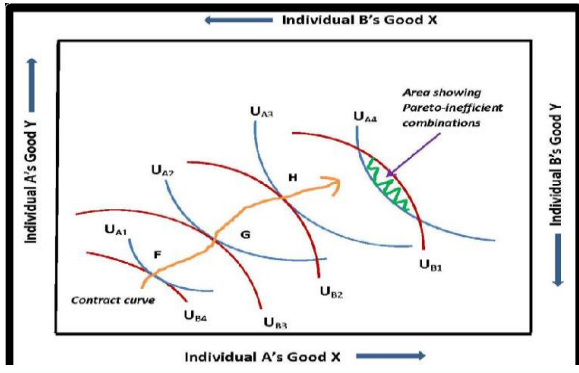


Chapter 17 - A Simple Exchange Economy

CHAPTER 16 LECTURE - GENERAL EQUILIBRIUM THEORY



1

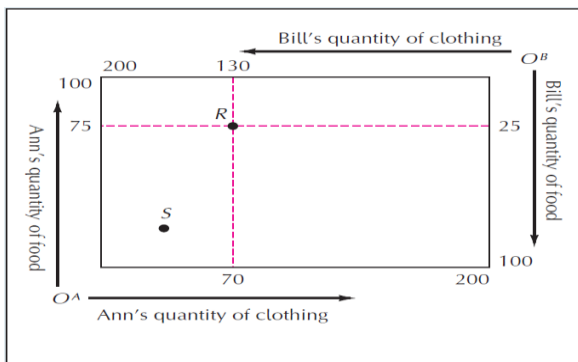
GENERAL EQUILIBRIUM ANALYSIS

- **General equilibrium analysis:** the study of how conditions in each market in a set of related markets affect equilibrium outcomes in other markets in that set.
- Simple economy in which there are only two consumers—Ann and Bill— and two goods, food and clothing.
 - *Allocation:* an assignment of these total amounts between Ann and Bill.
 - *Initial endowments:* the amounts of the two goods with which Ann and Bill begin each time period.

2

2

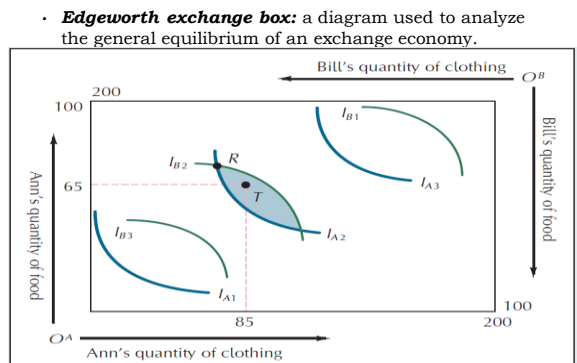
AN EDGEWORTH EXCHANGE BOX



3

3

EDGEWORTH EXCHANGE BOX - GAINS FROM EXCHANGE

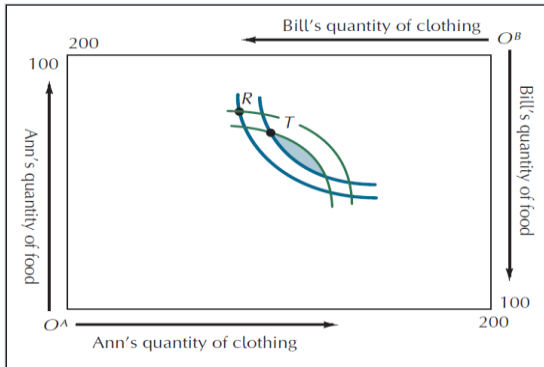


4

4

Chapter 17 - A Simple Exchange Economy

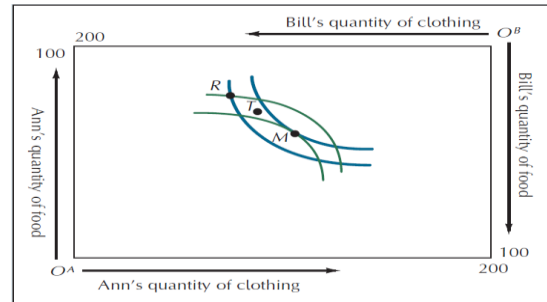
FURTHER GAINS FROM EXCHANGE



5

5

A PARETO-OPTIMAL ALLOCATION



$$[MRS_{X,Y}]_A = [MRS_{X,Y}]_B = \frac{P_X}{P_Y}$$

6

6

THE PARETO CRITERION

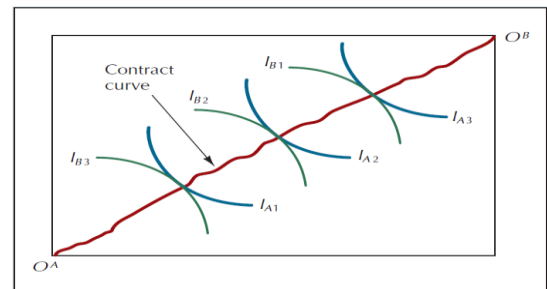
- **Pareto superior allocation:** an allocation that at least one individual prefers and others like at least as well.
- **Pareto optimal:** the term used to describe situations in which it is impossible to make one person better off without making at least some others worse off.

7

7

THE CONTRACT CURVE

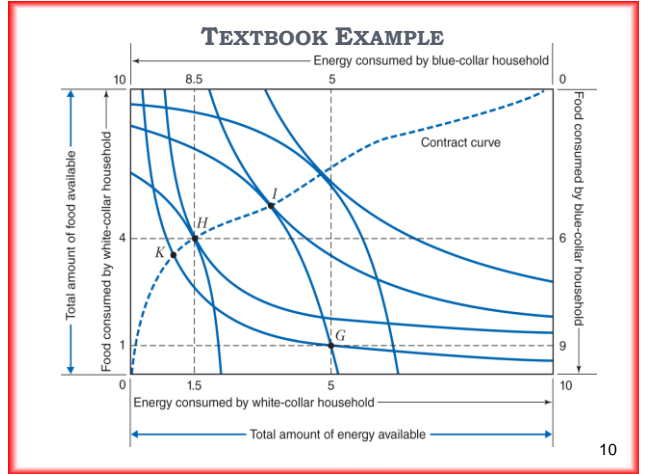
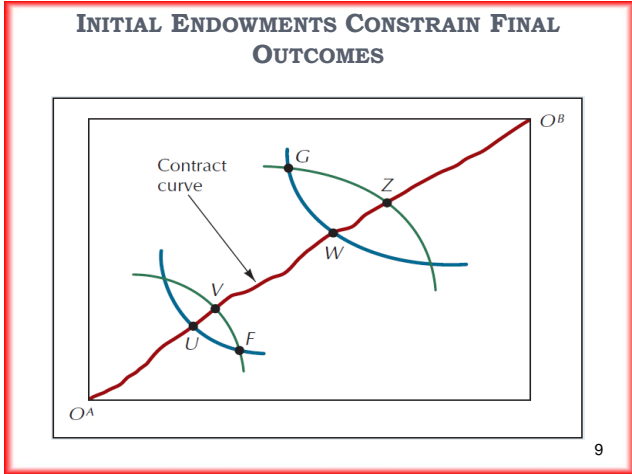
- **Contract curve:** a curve along which all final, voluntary contracts must lie.
- Identifies all the efficient ways of dividing the two goods between the two consumers.



8

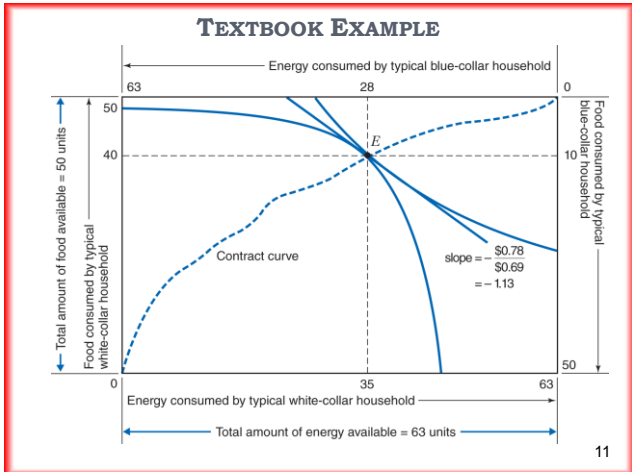
8

Chapter 17 - A Simple Exchange Economy

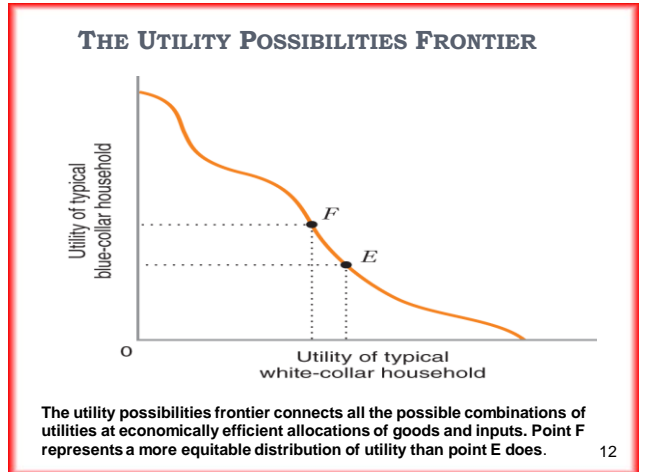


9

10

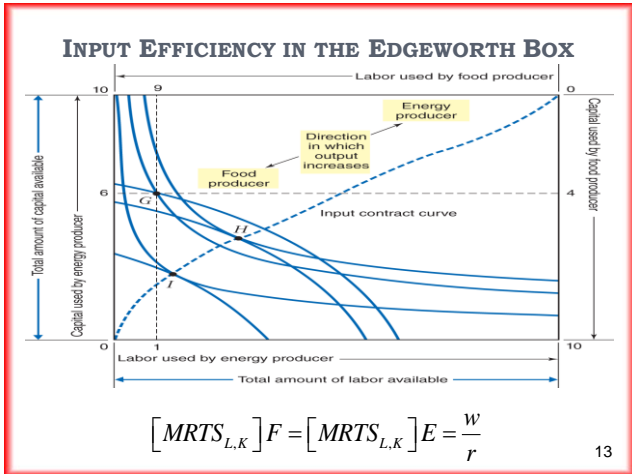


11

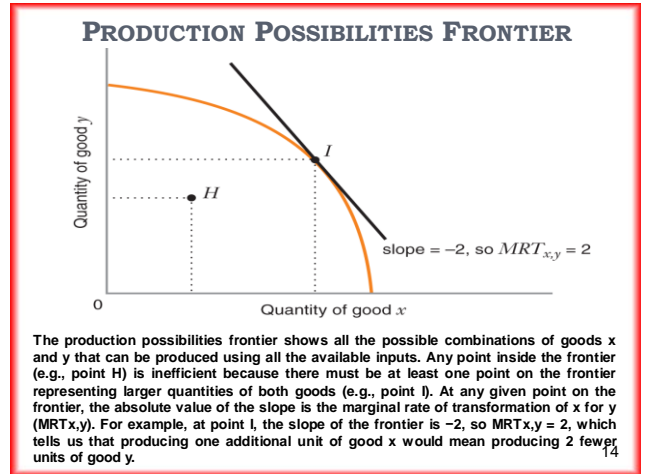


12

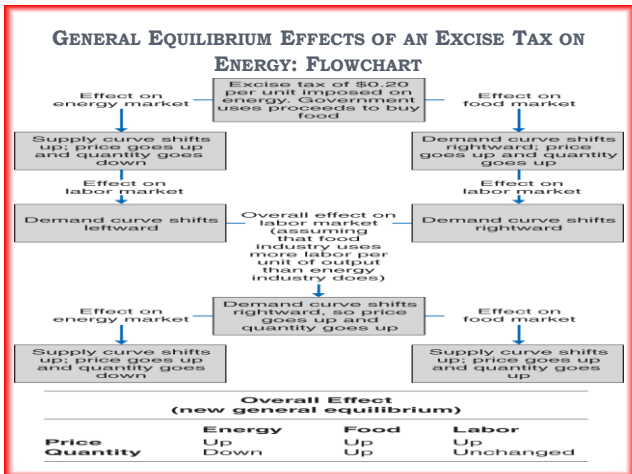
Chapter 17 - A Simple Exchange Economy



13



14



15



16