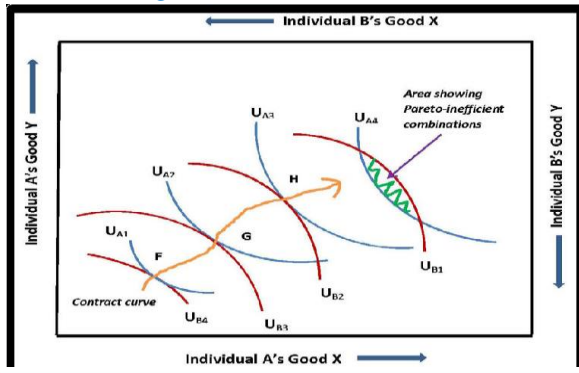


# Chapter 17 - A Simple Exchange Economy

## CHAPTER 16 LECTURE - GENERAL EQUILIBRIUM THEORY



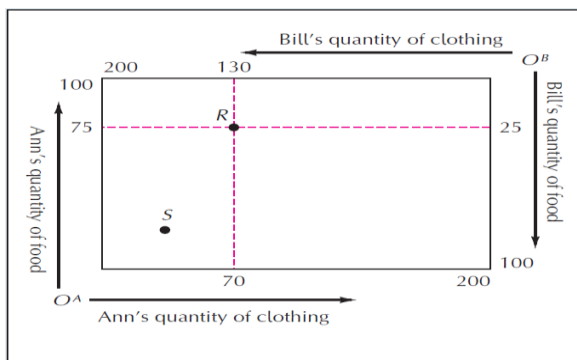
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## GENERAL EQUILIBRIUM ANALYSIS

- **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

## AN EDGEMORTH EXCHANGE BOX

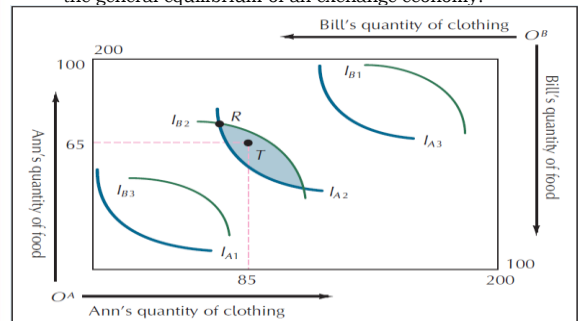


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## EDGEMORTH EXCHANGE BOX - GAINS FROM EXCHANGE

- **Edgeworth exchange box:** a diagram used to analyze the general equilibrium of an exchange economy.

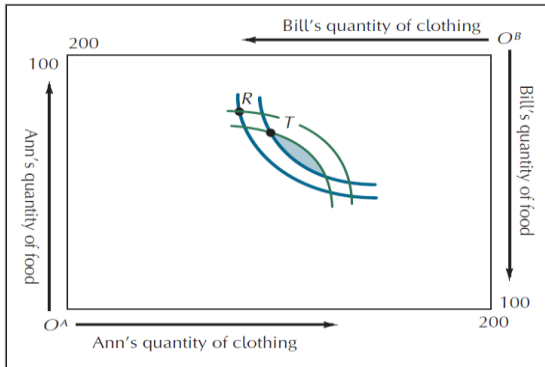


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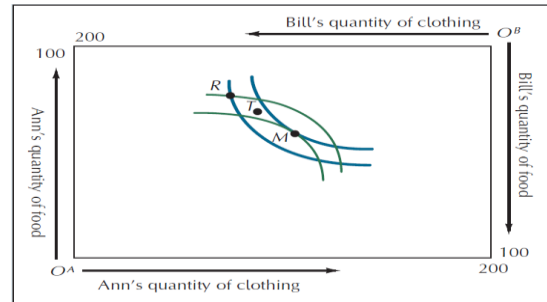
## FURTHER GAINS FROM EXCHANGE



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## A PARETO-OPTIMAL ALLOCATION



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

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## THE PARETO CRITERION

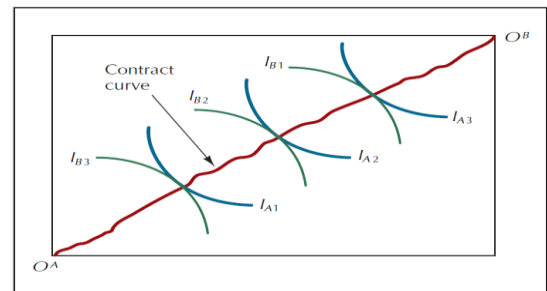
- **Pareto superior allocation:** an allocation that at least one individual prefers and others like at least as well.
- **Pareto optimal:** the term used to describe situations in which it is impossible to make one person better off without making at least some others worse off.

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## THE CONTRACT CURVE

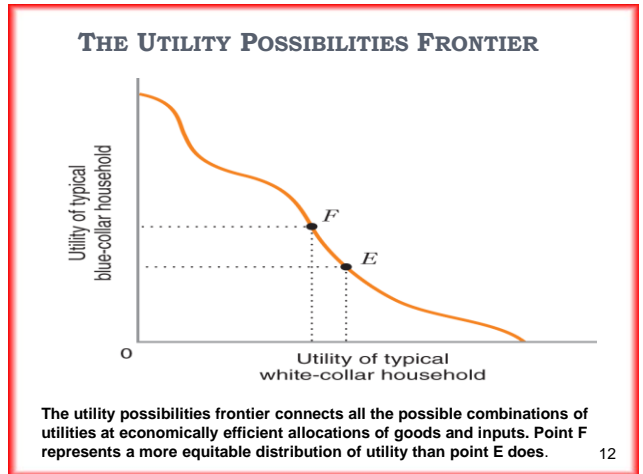
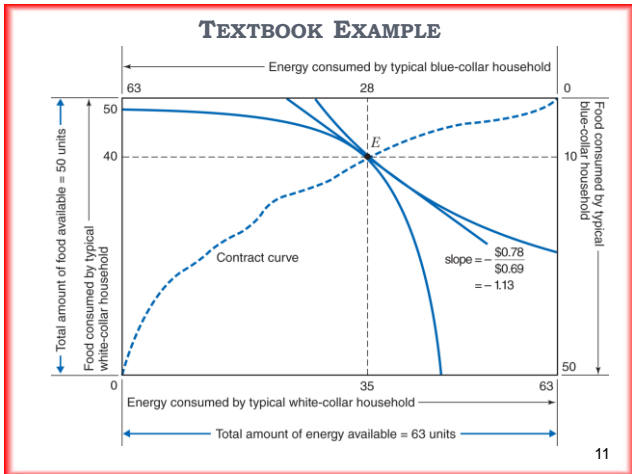
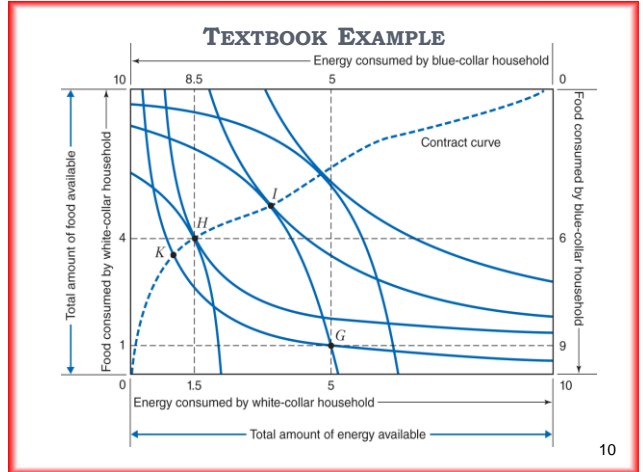
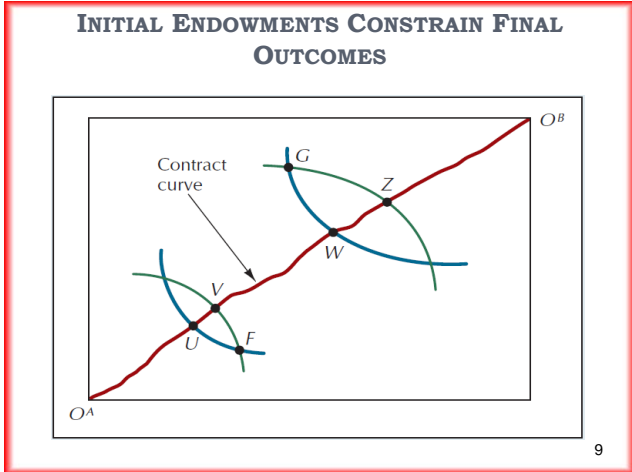
- **Contract curve:** a curve along which all final, voluntary contracts must lie.
- Identifies all the efficient ways of dividing the two goods between the two consumers.



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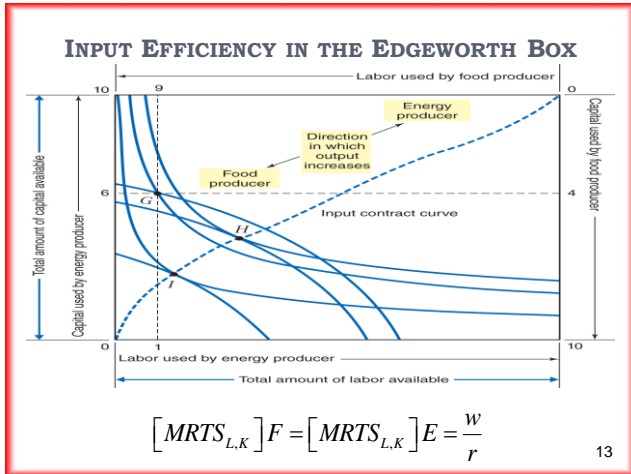
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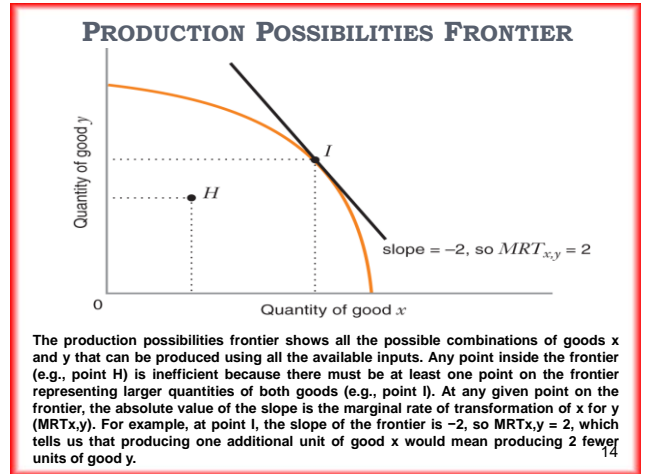
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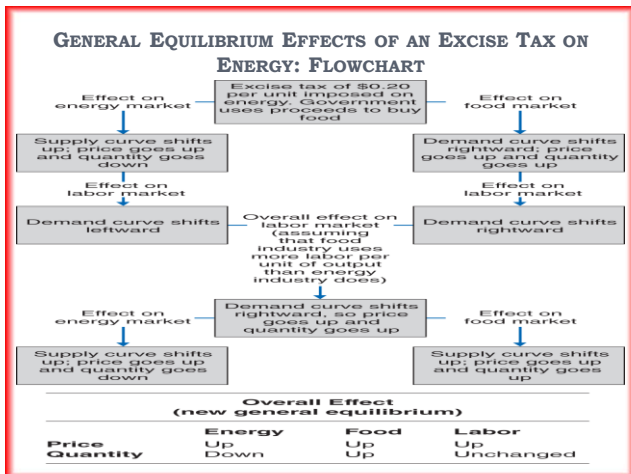
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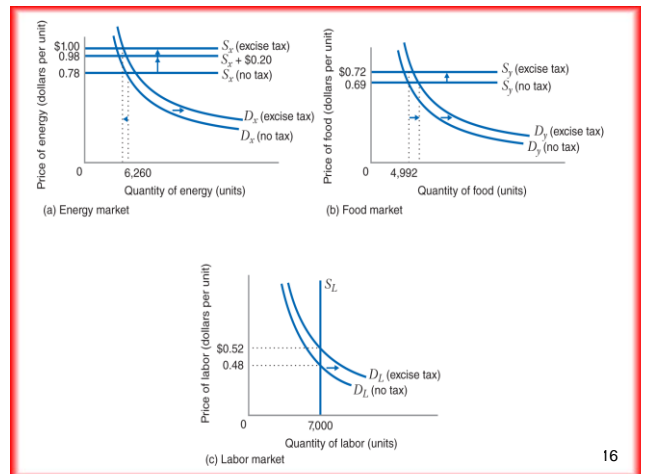
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