

General Comments on Problem Set 6

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From Problem Set 6, I have spotted some flaws which are related to the habit of computation and the way to answer questions. Students mainly made mistakes in Part b) and d) of Question 3. The most serious problem is to answer the question in a wrong direction, which I am unable to give any credits on. I hope that every one of you develop a good custom; on top of all, analyze questions and answer them to the point.

(1) Part c) and d) of Question 1.

We should first pay attention to the units used in these two parts. Part c) asks the change in CS and PS. Usually we do not use any unit to measure CS and PS; a simple number would be fine. But if we want to use euros, recall that Q is expressed in thousands of cars and P in hundreds of euros, so that we should put five more zeros after 400, 1600, etc, but only two more zeros. d) sees the same problem: the result measured in euros should be 64,000,000. Quite a number of you report a number without enough zeros.

Second, I would like you to form a good habit in computation. When we discuss about a certain change, we must distinguish the initial and ending points of the process. Clearly, here the initial point is without taxes while the ending point is with taxes. The change in CS should be the difference of CS with taxes and without taxes, which is $256-400=-144$. Likewise, the change in PS is also a negative value, -576 . The best way to report the result is that the CS is reduced by 144 or that the CS decreases by 144.

(2) Part b) of Question 3.

Many students confounded the question with "Why does the EU committee decide to subsidize the agricultural sector that much". Indeed, the question in b) can be paraphrased as follows: how can the subsidies on a small sector (relative to the total GDP) be that large? We then use the theory and state that the subsidy is costly because it has to cover every unit produced and even increases the production.

(3) Part d) of Question 3.

Again, many students did not understand the question. We should put much emphasis on how Europe can be the main beneficiary; in particular, how the removal of CAP instruments is possible to improve the farm sectors and other sectors.

Then the answer seems easy. CAP instruments are costly shown from the share of budget. The budget has to be balanced by taxation (for instance, income taxation, consumption taxation, etc). In the farm sector, although both consumers and producers have larger surpluses with subsidies (remember the deadweight loss we learn), the total amount of subsidy still exceeds the total surplus, which implies that consumers and producers may have a high tax burden as well. Even consumers and producers in other sectors have to be taxed to cover the huge amount of subsidies. So if CAP instruments are removed,

consumer's and producer's surpluses in the farm sector shrink but they also experience a lower tax rate. Then it is possible that they are better off. Agents in other sectors are definitely better off because of low taxes.