

Quiz 5

Econ 155, Winter 2008

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Answer each question listed below. Partial credit will be rewarded, so *show all work*.

Question 1 A local tannery produces leather at a private marginal cost of $MPC(q) = \$20 \cdot q$, and sells the skins for \$50. However, as is known to anyone who has seen the episode of the Discovery Channel's "Dirty Jobs with Mike Rowe" where Mike works at a tannery (No. 57), tanneries are very dirty places. The tanner in this question takes all of his excess waste, and dumps it into the local river. Each skin of leather produces \$10 worth of pollution.

- What is the marginal social cost of tanning a skin of leather?
- What would be the efficient tax to impose on the tanner?
- In lieu of this tax, your friend suggests making leather illegal, so that there is no more tannery pollution. You suggest this is a bad idea, and your explanation includes the phrase "efficient level of pollution." What was your explanation?

Question 2 Suppose a local politician advocates making collision insurance mandatory, along with liability insurance. "Car insurance is car insurance—and we want to keep our roads safe. Think of the children!"

- You, a student of economics, are wary of this proposal. What economic inefficiency does the mandatory provision of liability insurance limit? Are the circumstances the same for collision insurance?
- Will this proposal lead to its proponents' goal—safer roads for all? (Hint: will it lead to *safer driving* by all?)