

# Adv. PSE I: Tutorial 05

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In addition to exercise 11 we will also discuss exercise 7.

## 11 Quality Competition

Chapter 6 introduced a simple model of quality competition. Here, we will revisit some features of the model. Use the “model on page” to answer the following questions.

- a) Identify equations that represent assumptions! State each assumption as an English sentence!
- b) Which equations represent the DD and EE curves?
- c) What is the economic intuition of each curve?
- d) Draw the  $x, q$ -diagram discussed in class.
  - i) Why are the two curves shaped the way they are?
  - ii) Which point represents the market equilibrium without regulation?
  - iii) Which point represents the welfare optimum?
- e) How can the government implement the optimum?
- f) Now, assume an open economy with many small countries:
  - i) Under which assumption will governments still implement the welfare optimum if there is no supra-national regulation?
  - ii) Why is this assumption unlikely to be true?
  - iii) Which outcome will prevail instead of the welfare optimum?

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