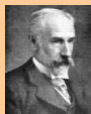


The Edgeworth Box



The Basic Theorem

- The basic theorem in welfare economics:
A market, exchange, economy will achieve efficient resource allocation.
- We intend to show the basics of that proof.

Some Basic Assumptions

- A simple economy: Harry and Sally.

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- A simple economy: Harry and Sally.
- There are two factors of production, capital, K, and labor, L.

$$L = L_H + L_S$$

Some Basic Assumptions

- A simple economy: Harry and Sally.
- There are two factors of production, capital, K, and labor, L.

$$L = L_H + L_S$$

- These two factors of production can be used to produce either apples or bananas.

Three Basic Questions

1. How many apples and how many bananas should be produced?

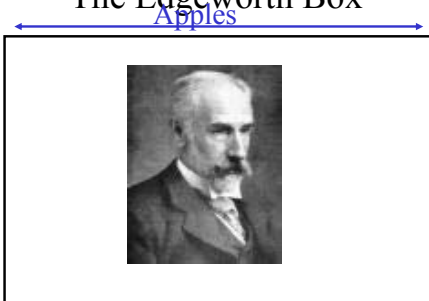
Three Basic Questions

1. How many apples and how many bananas should be produced?
2. How should the apples and bananas be allocated between Harry and Sally?

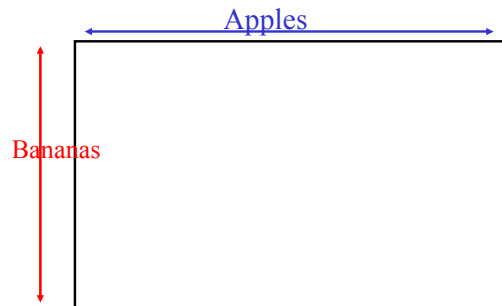
Three Basic Questions

1. How many apples and how many bananas should be produced?
2. How should the apples and bananas be allocated between Harry and Sally?
3. How should capital and labor be allocated to the production of apples and bananas?

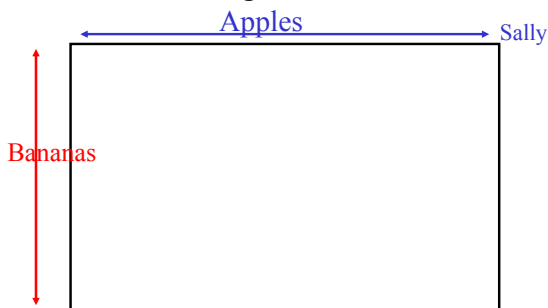
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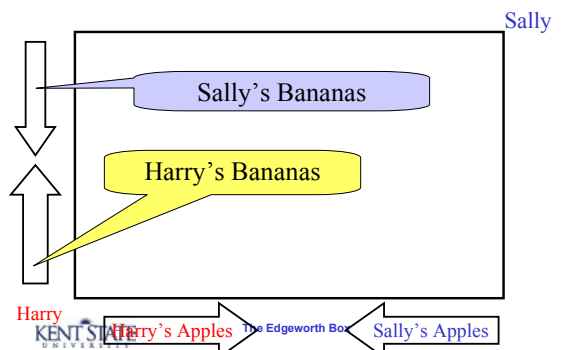
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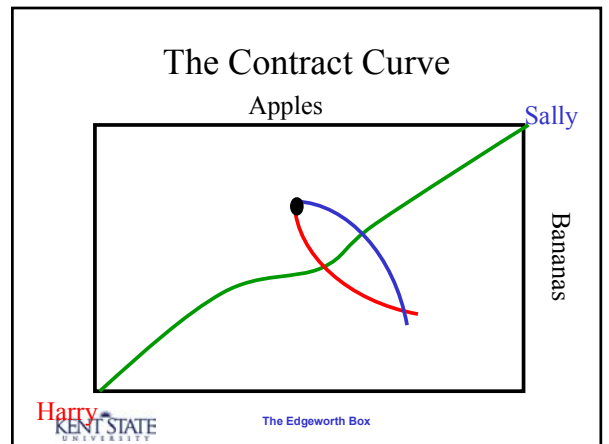
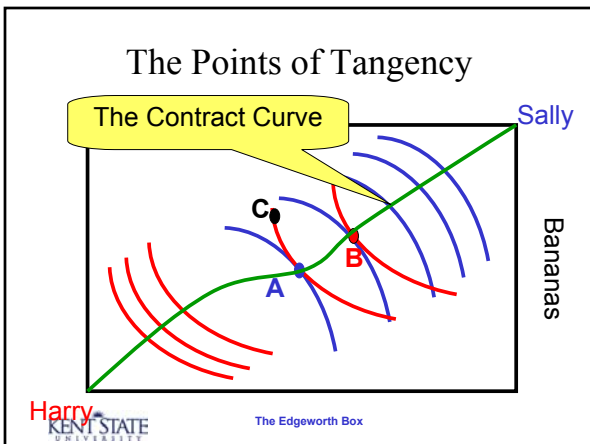
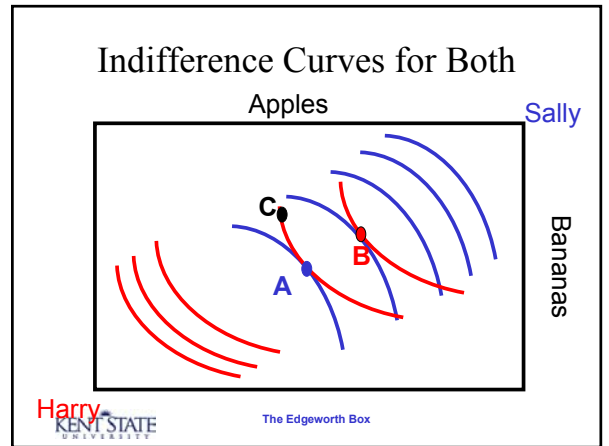
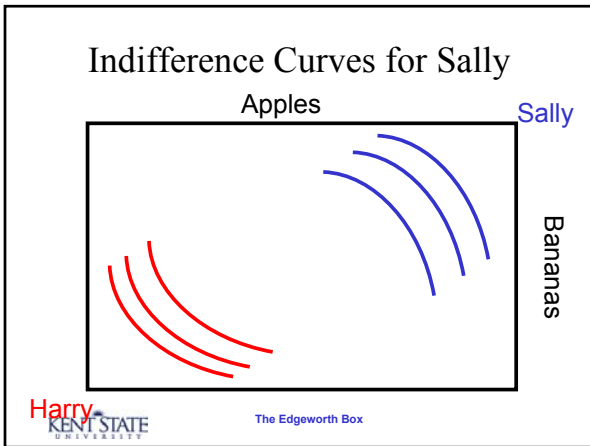
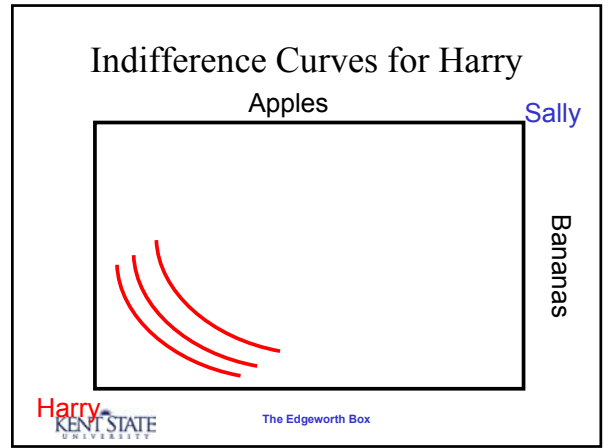
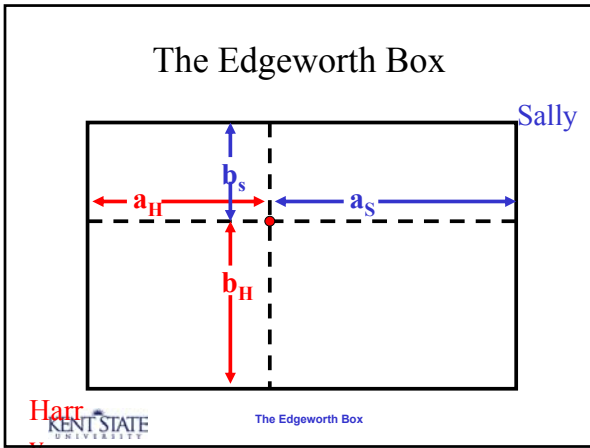


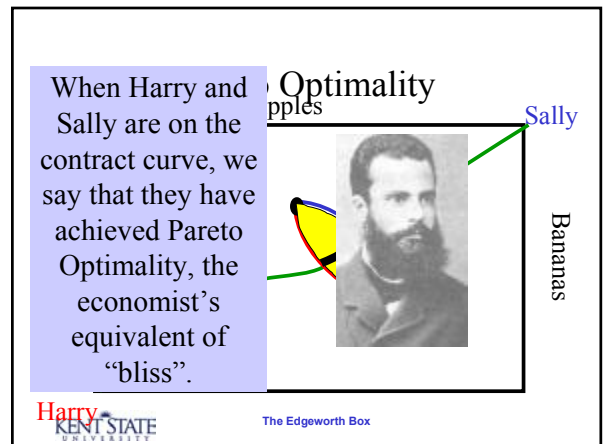
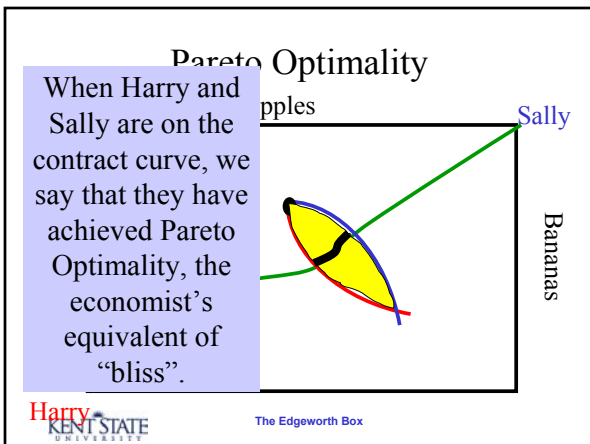
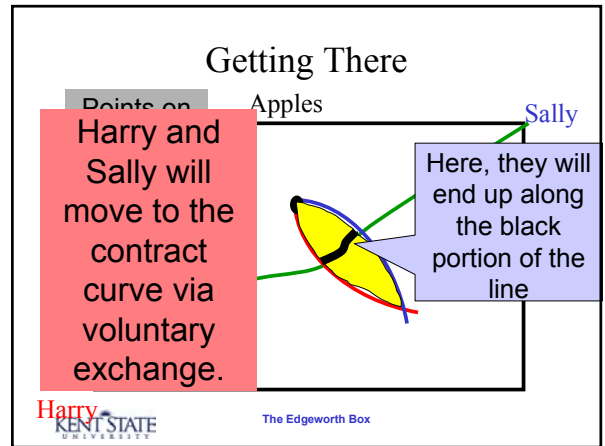
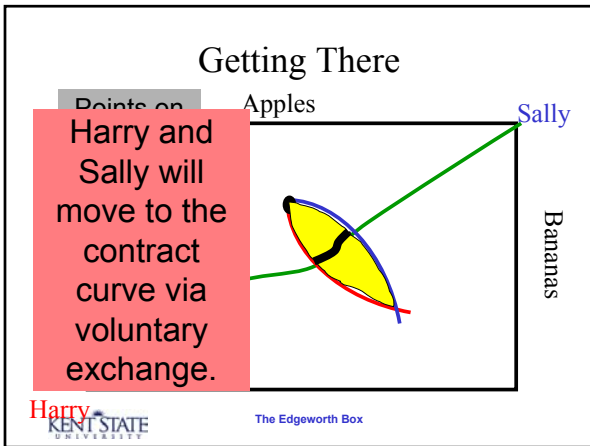
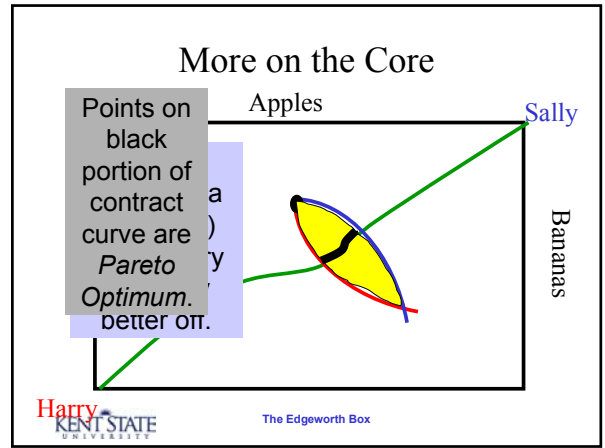
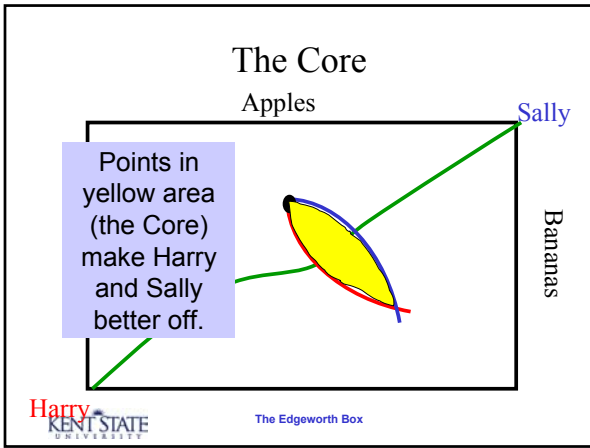
The Edgeworth Box



The Edgeworth Box







Optimality

When Harry and Sally are on the contract curve, we say that they have achieved Pareto Optimality.

It is impossible to make Harry better off without making Sally worse off (or vice versa).

Harry

Sally

Bananas

Apples

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Optimality

When Harry and Sally are on the contract curve, we say that they have achieved Pareto Optimality.

If they are not on the contract curve, it is possible to make one or both better off without making the other worse off.

Harry

Sally

Bananas

Apples

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End

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