



[Frequently Asked Questions]

Pareto Optimality and Grand Utility Possibility Frontier

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| Unit No. & Title: | Unit – 3 General Equilibrium |
| Lecture No. & Title: | Lecture – 2 Pareto Optimality and Grand Utility Possibility Frontier |

Frequently Asked Questions

Q1. The Walras law refers to which type of markets?

A1. The Walras law refers to the aggregation of the markets for final goods and services along with the markets for raw materials, labor, and capital

Q2. What does the grand utility possibilities frontier show?

A2. The grand utility possibilities frontier shows all the Pareto optimal combinations of utility that the consumers may derive from consumption of all possible combinations of goods that are produced when inputs are used in the most efficient manner possible.

Q3. Why the grand utility possibilities curve is called an 'envelope' curve'?

A3. The grand utility possibilities curve is an 'envelope' curve' constructed by taking the outermost points of the collection of all the possible utility possibility frontiers. Any point interior to the grand utilities possibilities frontier will be less preferred according to the Pareto criterion.

Q4. What does Welfare economics study about the general equilibrium?

A4. Welfare economics, among other things, studies the conditions under which optimal solutions to the general equilibrium model can be achieved. This requires, among other things, an optimal allocation of factors among commodities and an optimal allocation of commodities among consumers.

Q5. Whether the achievement of Pareto optimality indicates the achievement of maximum social welfare?

A5. The achievement of Pareto optimal state in the economy required the fulfillment of some marginal conditions. Although Pareto optimality is necessary but it is not the sufficient condition for the maximization of social welfare.

Q6. If the MRS's are equal across all consumers whether efficient product mix has been achieved or not?

A6. No. The consumption efficiency is achieved for the given product mix, but the given product mix is efficient only if MRT equals the MRS for all pairs of goods.

Q7. What does social welfare function provide?

A7. The social welfare function provides a ranking of alternative states in which different individuals enjoy different levels of utilities.

Q8. At which point of the grand utility possibilities curve the social welfare is maximum?

A8. Social welfare is maximized at the point of tangency of the grand utility possibility with the highest possible social indifference curves.

Q9. In the study of Welfare Economics how many theorems are considered important?

A9. There are two fundamental Social welfare is maximized theorems of welfare economics. The first theorem states that every competitive economy is Pareto efficient. The second theorem states that every Pareto efficient resource allocation can

be attained through a competitive market mechanism, with appropriate initial redistributions.

Q10. What is pure exchange econom?

A10. An economy is called pure exchange economy when the quantities supplied of all goods are fixed and the main economic problem is how to allocate amounts of the goods among consumers, using trade.