Assignment #2
Due December 6, 2004 by 3 pm
50 points.

You may discuss this homework assignment with anyone except agricultural economics faculty. You must however turn in your own work. Please type your answers using double spacing 12 point font. You may hand draw graphs. I have put approximate page length for answers by each question as a guide for you to judge the length of the answer. Turn your exam in by either email or in person in class. (email address is batie@msu.edu).

1. Thoroughly discuss and explain the following quote, explaining carefully what the authors meant by contingent valuation, WTP, WTAC, Hicksian equivalent or compensating surplus or variation. (2 pages)

   In contingent valuation surveys, for example, people may be asked to state their preferences for the environment. This request might consist of asking people for their maximum willingness to pay (WTP) for an increase in environmental quality or their minimum willingness to accept compensation (WTAC) to forgo such an increase. Respondents might instead be asked about their maximum WTP to avoid a decrease in environmental quality, or their minimum WTAC to accept this reduction. Because the level of environmental quality is usually chosen by a third party (such as the government requiring a certain level of air quality measures to be achieved) and not by the individual being questioned, these measures correspond to either Hicksian equivalent or compensating surplus (rather than equivalent or compensating variation, where quality/quantity is chosen by the individual).

2. The theory of economics suggests that the two basic concepts of valuing benefits and losses: willingness to pay for a benefit (prevent a loss) and willingness to accept compensation to forego a benefit (a loss) should not differ much when valuing the same benefit (or loss). However, empirical studies suggest there are marked differences between the two measures. Discuss why these measures might yield differing empirical results. (1-1/2 pages)

3. A real estate firm is interested in the marginal willingness to pay by real estate consumers for homes located with views of wetlands. The real estate firm has asked you to conduct a hedonic analysis of home characteristics. Describe how you would carry out the analysis, being sure to discuss (a) what characteristics of homes you will measure, (b) how you would measure the hedonic price function, and (c) how you would translate this knowledge into a marginal willingness to pay function. (2 pages)