Answer on Question 85643 -Economics - Microeconomics
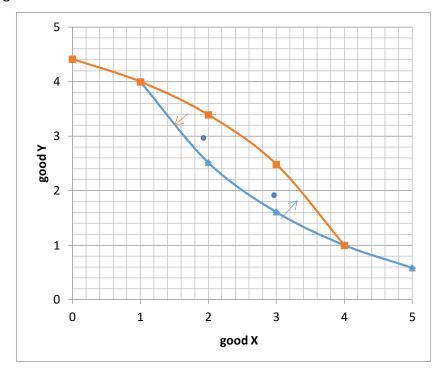
Assuming the two goods X and Y and two persons, analyze the exchange of goods between the two using the Edge worth Box framework indicating the Pareto efficient allocation

Answer.

In order to use Edgeworth box we have to show indifference curves for both persons on the same graph, assuming, that one person gets all leftovers after the other one, and total amount of good X and good Y are 5 and 5 respectively (for example). So, we rotate one the graphs in 180 degrees.

As it can be seen, current bundles are not optimal, because indifference curves form a "lens" in the space of the Edgeworth box, any point within which takes each of the participants to a higher level of utility.

Pareto optimal allocation in the Edgeworth box lies at the point of contact, not interception of indifference curves. But in this case the point of contact lies at the fractional units of good X and good Y, so we choose discrete ones.

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