UNIT -2

Q: What is user cost?

Ans: User cost is the opportunity cost of postponing extraction of a non-renewable resource. It is the present value of the marginal profit from selling the resource in the future.

Q: What is Augmented User Cost (AMC)?

Ans: Augmented user cost is the opportunity cost of not depleting the resource is added to the marginal cost. The miner's decision to extract depends on his AMC rather than MC.

$$AMC = MC + UC$$

Q: Explain the conditions of optimal depletion of non-renewable or exhaustible resources.

Ans: In hotellings rule there are conditions for optimal depletion of the exhaustible resource.

Hotelling's rule

An efficient non-renewable resource depletion programme requires the resource's royalty value to grow over time at a constant rate equal to the market interest rate.

In other words, the discounted value of a royalty of extracting one unit of oil has to be the same at any point in time.

These conditions are:

A.) In percentage, equilibrium exists when the price is equal to marginal cost.

B.) The case of NRR (Net Production Rate) the price equals Augumented user cost and equals to marginal cost plus User cost.

C.) Postponing extraction of the resource for the future involves preference of time.

D.) The future price should exceed present price of extraction to provide compensation for the loss of present earnings resulting from conservation.

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