Practice Final

5. Individuals cannot always internalize externalities because there are transaction costs. Examples of transaction costs include:

    a) The costs of making legally binding agreements
    b) Costly delays in bargaining
    c) Costs of communication among the interested parties
    d) All of the above

7. When demand is unit-elastic,

    a) A one percent change in price leads to more than one percent change in quantity demanded
    b) Changes in price have no effect on total revenue
    c) A one percent change in price leads to less than one percent change in quantity demanded
    d) A rise in price reduces total revenue

8. The Coase theorem shows that:

    a) Government intervention is always necessary when there is an externality
    b) The legal rights of different parties will always determine the outcome of who will actually impose the externality on others
    c) Transaction costs are not relevant when deciding whether the economy will reach an efficient outcome in the face of externalities
    d) None of the above

9. In some industries, monopolists persist because:

    a) There are barriers to entry
    b) In some industries, there are significant economies of scale
    c) Monopolists face an infinitely elastic demand curve
    d) (a) and (b)

10. The kinked demand curve model illustrates:

    a) How consumers can have very unique tastes
    b) How monopolists can price discriminate
    c) How an oligopolist who faces a change in his/her marginal cost may choose not to adjust output and price
    d) How oligopolists will always choose the non-cooperative Nash equilibrium

2) (10 points) Draw and label a graph showing a monopolist making economic profits. What is the profit-maximizing output? How big are the economic profits? Indicate in your graph. Why is marginal revenue lower than the price with a monopolist? Why does marginal revenue equal to the price with a perfectly competitive firm?

3) (10 points) Suppose in the shoe industry, the U.S. government decides to impose a tariff. Draw and label a graph showing the effects of a tariff. What happens to the domestic price of shoes? What happens to imports? What happens to consumer surplus? What happens to producer surplus? What happens to total surplus?

(2)

4) (10 points) a) Suppose the production of semiconductor chip generates external benefits. Draw and label a graph showing how without government intervention, the market produces the quantity of chips that is lower than the socially optimal quantity. Explain why the marginal social benefit curve is higher than the market demand curve.

b) Indicate in a separate graph showing how an optimal Pigouvian subsidy to chip producers can lead to the production of chips to be at the socially optimal quantity. What happens to the price facing the producers after the subsidy is imposed? Indicate in your graph.

5) (10 points) Draw and label a graph showing the total surplus with a perfectly competitive industry. Assume that the marginal cost is constant. In a separate graph, show the total surplus under a monopoly. Assume that the marginal cost is the same as in the perfectly competitive case. Compare the total surplus in your graph under perfect competition and the graph under a monopoly, which one has a higher amount of total surplus? Show in your graph the deadweight loss. Why do economists view monopoly unfavorably?

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6) (10 points) a) Consider the three market structures: perfect competition, monopoly and oligopoly. What are the distinguishing characteristics of these three forms of market? List at least three features.

b) Draw and label a perfectly competitive firm in the short run whose optimal action is to shut down. Why does the firm in your graph choose to shut down?