Practice Final #2 Answer Key

Multiple Choice Questions

1. D

2. Don’t worry about the kinked demand curve of the oligopolist…we did not cover this

3. A

4. B

5. C

6. A

7. D

8. D

9. D

10. D

11. D

12. B

13. D

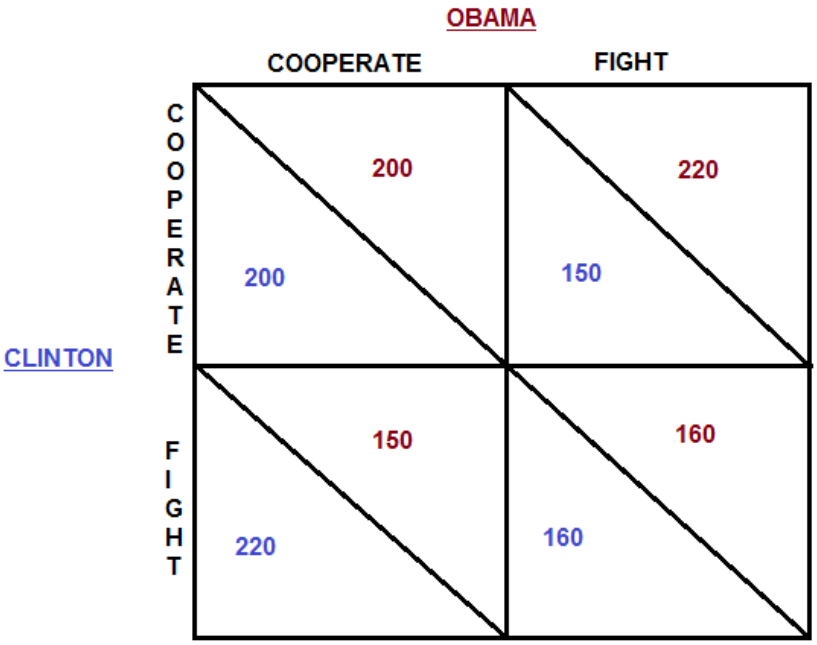
14. both B and C are correct

15. E

Short Answer Questions

1. Prisoner’s Dilemma

a.

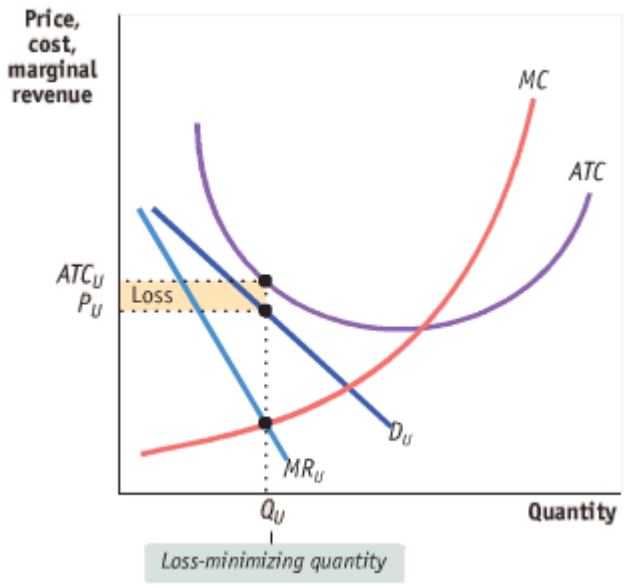


The (Nash) equilibrium will be fight-fight. The dominant strategy is fight because, regardless of what the other player does, it is always better (the payoff is higher) for fight.

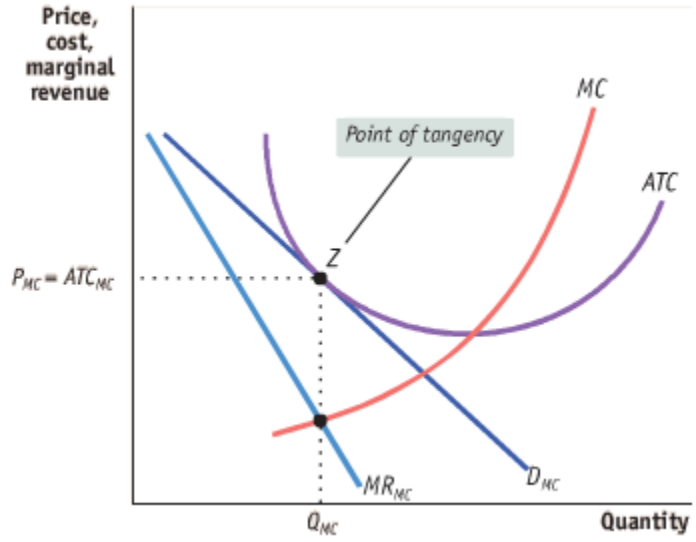
b. If the game occurs repeatedly over time, cooperation may emerge. This depends on how long the players think they will play the game and what they think their opponent will do. If they think their opponent will cheat no matter what, they are better off cheating. If they think their opponent will cooperate, they may be better off to also cooperate if they think they will play the game for a long time. If they instead only think they will play the game a few times, they may still be better off to cheat.

2. Monopolistically Competitive Firm

a) In the short-run (incurring economic losses):



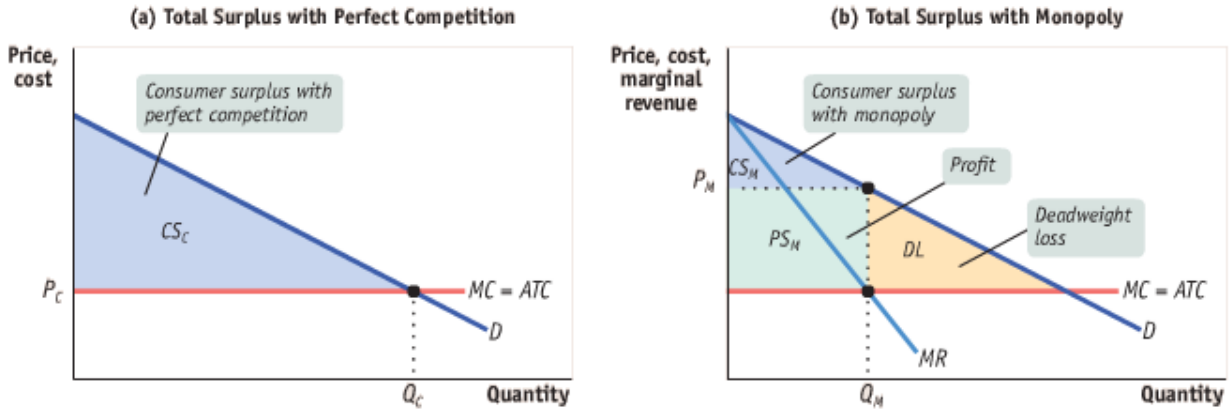
b. In the long-run:



Profits are zero in the long-run. There is excess capacity because at the long-run outcome, ATC is not minimized by the monopolistically competitive firm.

3. You will not be responsible for knowing *this* specific modeling of externalities. Know how to analyze negative externalities using the MSC and MSB curves and how to show the differences between a uniform standard and a Pigouvian tax (see #6).

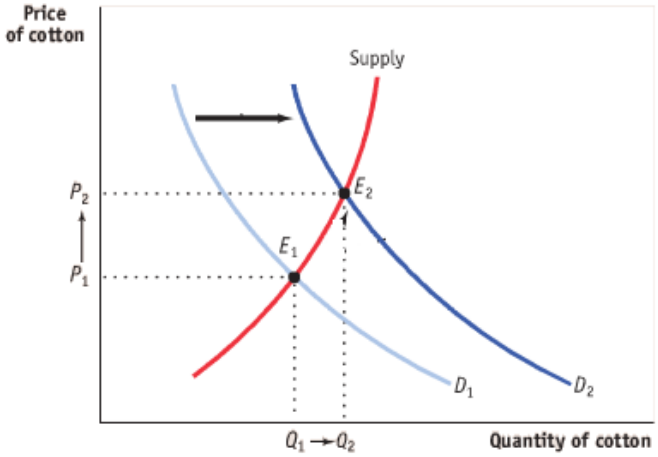
4. Monopoly versus Perfect Competition



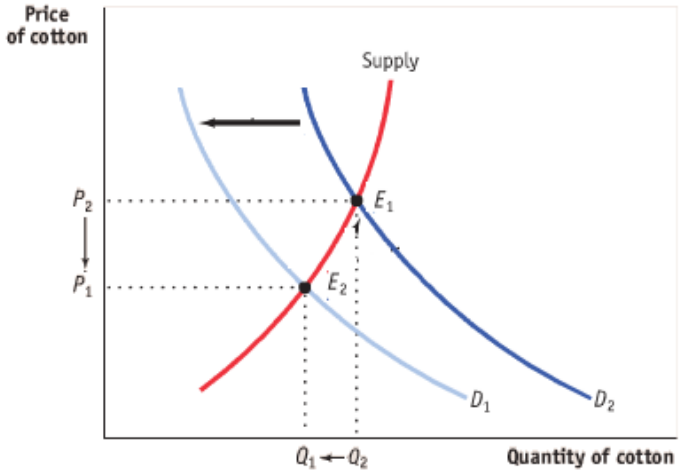
Total surplus is higher in perfect competition compared to monopoly. Economists view monopolies unfavorably because monopolists reduce quantity below the social optimum in order to raise price and profits. This results in lost mutually beneficial transactions and results in deadweight loss.

5. Shifts of S&D in the Market for Hamburgers

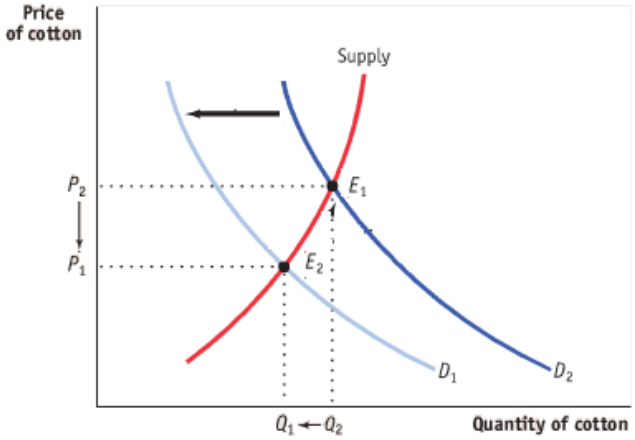
a. price of tacos (substitute) increases ➔ demand for hamburgers increases ➔ P and Q increase



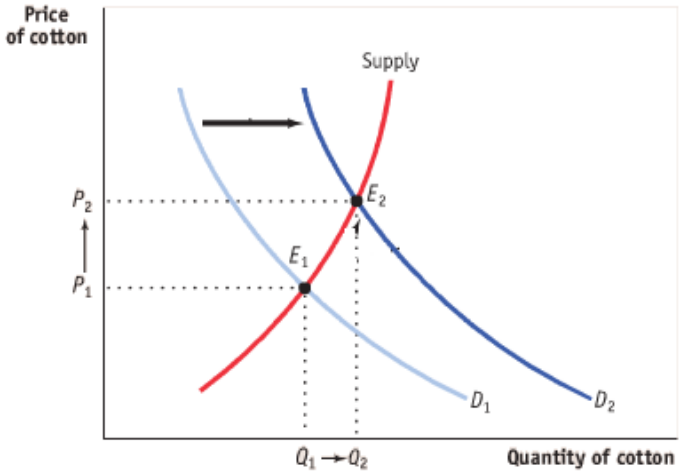
b. price of french fries (complement) increases ➔ demand for hamburgers decreases ➔ P and Q decrease



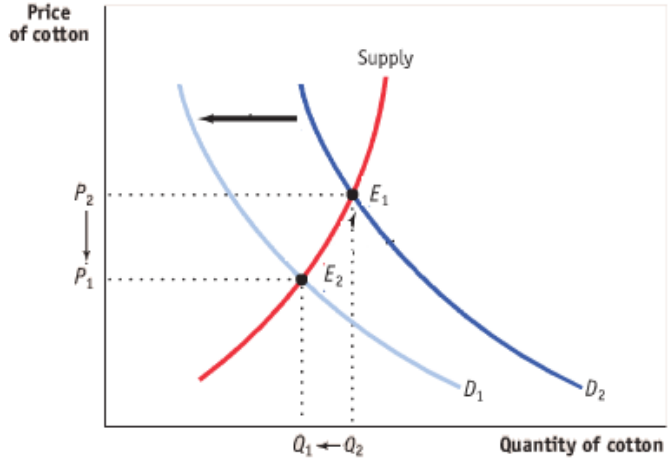
c. income falls ➔ hamburgers are normal good ➔demand for hamburgers decreases ➔ P and Q decrease



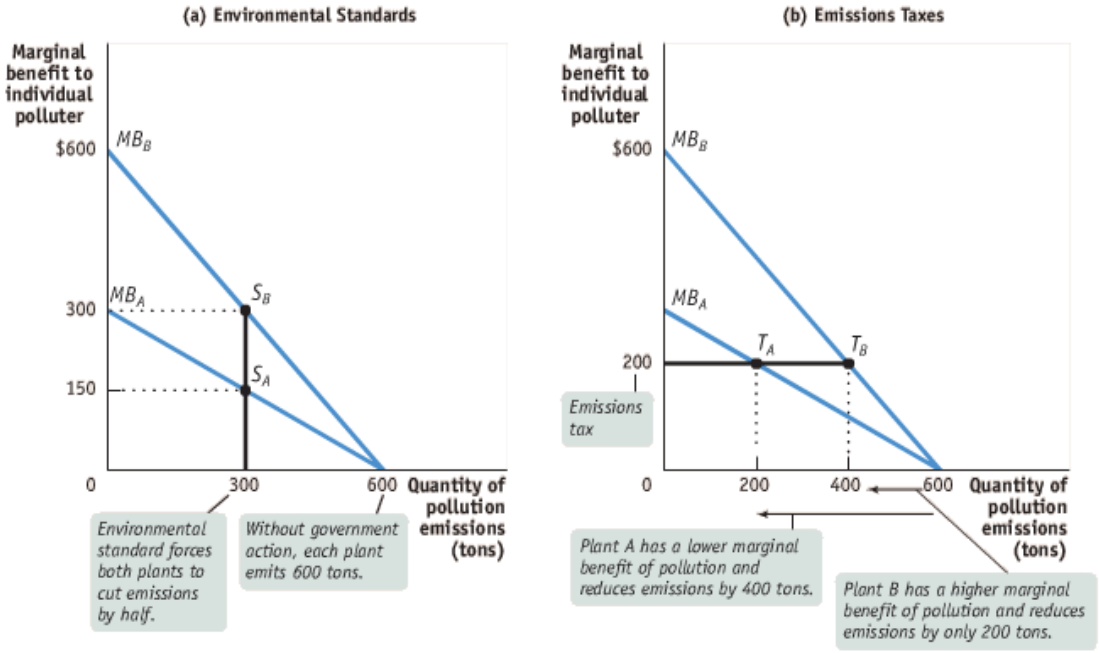
d. income falls ➔ hamburgers are inferior good ➔ demand for hamburgers increases ➔ P and Q increase



e. price of hot dogs (substitute) falls ➔ demand for hamburgers decreases ➔ P and Q decrease



6. Uniform Standards versus Pigouvian Taxes



The emissions tax is more efficient than the environmental standard because it achieves the same amount of pollution reduce (600 units total) at a cheaper cost. Under the uniform standard, $MB_B > MB_A$ which implies it is more expensive for firm B to reduce pollution to this level than for firm A. We can reduce the total cost of pollution reduction by allowing B to pollute more and instead having A pollute less. Under the emissions tax, the MB to both A and B is same (and is equal to the tax). There is no way to rearrange abatement to reduce the cost of reducing pollution.