Econ 101 Discussion Section-Handout 12

Emilio Cuilty

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1 Review

- Monopoly: Why should we care?
  - We have several examples of monopolies in real life.
  - Monopolies some time can extract all consumer surplus, and that is really bad news
  - There are several policies in different countries against monopolies
- How they set price?
  - Marginal Revenue= Marginal Cost
- Why is not like perfect competition?
  - Now they face a down slopping demand, and so marginal revenue is not the same as just price
- How a monopoly continues in the power?
  - Barriers: Natural, political, or fictional

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1. Assume that the market for ice cream on the Terrace at UW-Madison is perfectly competitive. Each ice cream cart on the Terrace has the same total cost function curve and marginal cost curves. These cost curves are given by the following equations where q is the number of servings of ice cream: Total Cost Curve for Representative Ice Cream Cart:

$$TC = q^4 + 3$$
$$MC = 4q^3$$

   The break-even price of a serving of ice cream is ____ and the shut-down price of a serving of ice cream is ____.

   (a) \$1, \$0
   (b) \$1, \$3
   (c) \$4, \$3
   (d) \$4, \$0

2. Suppose now that the market demand for ice cream is given by the following equation where Q is the market quantity of ice cream servings and P is the price per serving: Market Demand Curve: Q = 100 – 2P How many servings of ice cream are supplied when this market is in long run equilibrium? Assume that all of the above information is still true and that everything has been held constant.

   (a) 100 servings of ice cream

(b) 94 servings of ice cream

(c) 92 servings of ice cream

(d) 98 servings of ice cream

3. How many ice cream carts will be present when this market is in long run equilibrium?

   (a) 25 ice cream carts

   (b) 23 ice cream carts

   (c) 92 ice cream carts

   (d) 94 ice cream carts

4. 1. Suppose a market is initially in equilibrium. At this equilibrium the absolute value of the price elasticity of demand is larger than the absolute value of the price elasticity of supply. If the government imposes an excise tax, then a larger fraction of tax revenue comes out of the _______ surplus.

   (a) Consumer

   (b) Producer

5. The government is considering imposing an excise tax of $2 per unit on a good. If the suppliers collect the tax for the government, which of the following statements about the economic incidence of this excise tax is true?

   (a) Consumers do not bear any of the economic burden of the excise tax.

   (b) Suppliers bear most of the economic burden of the excise tax.

   (c) The economic burden of the excise tax is split equally between consumers and suppliers.

   (d) We need more information to know who bears the economic burden of the excise tax.

6. Suppose a monopoly faces a market demand curve of $P = 42 - Q$ The Marginal cost faced by him is given by the equation : $MC = Q$

   (a) Derive the equation for marginal revenue curve.

   (b) Find the profit maximizing level of production for this monopolist.

   (c) What should be the price charged by the monopolist ?

   (d) What is the socially optimal price ?

   (e) What's this monopolist's total revenue?

   (f) Graph the producer surplus, the consumer surplus, and the dead-weight loss for the market with the monopolist.

      i. Compare the Social Surplus had this industry been perfectly competitive.