Chap 7 questions (Key)
For Econ 100
Essentials of Economics - 6th ed.
by Paul R Gregory

Ryan Keep

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1) Cite an example of a pure monopoly that is not regulated by government.

De Beers - Diamonds - why? because it has barriers to entry, due to the fact that they (DeBeers Co) owns the diamonds. Over time however with tech. and the finding of diamonds other places in the world DeBeers may not be a pure monopoly.

2) Explain why price-searching power is limited when there are few barriers to entry.

If there are few barriers to entry once economic profits are being made other firms will enter into the market increasing the supply and driving down profits for each of the firms using the perfect competitive markets or monopolistic competition.

An with each of the models there are large numbers of firms. This fact makes it hard to work together to set prices.
3) A monopolist can sell 100 units at price \$5 but must lower the price by \$2 in order to sell 110 units. What is the marginal revenue of producing the 10 extra units?

\[
P \quad Q \quad TR = P \times Q \quad MR = \frac{\Delta TR}{\Delta Q}
\]

\[
\begin{array}{ccc}
P & Q & TR \quad P \times Q \\
5 & 100 & 500 \\
3 & 110 & 330 \\
\end{array}
\]

\[
\frac{330 - 500}{110 - 100} = \frac{-170}{10} = -17
\]

Therefore if \( MR \) is neg, then no monopolist produce there because no monopolist produce with neg MC or in the inels region of the demand curve.
4) Explain why $P > MC$ results in economic inefficiency.

Assuming the $P > MC$ there is no way that both $P$ can be target to the min ATC if $P$ is down sloping.

- $ATC$ min target is $= 0$
- $P > MC$ make Demand downward sloping and must have a neg slope

$(-) \neq 0$

- The 2nd point point (and Bigger Point)
Allocative Efficiency is $P = MC$

The money price of any product is society's measure of the relative worth of an added unit.
5) Consider an industry comprising four equal-sized firms. Explain what factors determine whether it would be easy or difficult to collude. If the industry price is $10 would cheating on agreements be more likely if the average cost were $9.50 or 7.00.

If the industry price is equal to $10, we will have to look at 2 cases.
If the $P = 10$ and $ATC = 7$ the profits are large and the idea to collude in keeping the price high is great. However the gains from cheating are equal as great, with great pressure to collude would be difficult.

The gains from cheating would be small and the promise that was made may hold.
6) Explain how some oligopolists can cooperate without formal agreements. Oligopolists can often benefit from collusion, but because of anti-trust law collusion is illegal.

The major way oligopolists would collude without formal agreements would be use a Price-Leadership model. This is done in many different ways. (Conscious Parallelism)

1) Price leadership entails a type of implicit understand: by a hand-shake.

2) Infrequent Price Changes - that way everyone knows what the price is.

3) Communications - By publicizing the price changes.

4) Limit pricing - by setting a price that all firms can make some profit without letting new firms into the market.
7) Explain the following statement: "Greed creates cartels, and greed destroy cartels".

Most Oligopoly firms understand if they are to work together that both or are all firm would be benefited. However, there is always a reason to cheat because the pay off would be great in the short run. We can use a pay off matrix and show a Nash equilibrium.

![Payoff Matrix]

The outcome shows 10-10 not the higher 20-20.
8) Explain why an Oligopolist's marginal revenue is difficult to calculate.

Oligopolist's face many different issues in solving the MR curve that they face.
1) Is there a cartel if so the MR curve be be the same as a monopoly: however we know that it is hard to keep a cartel going because of greed.

2) Each firm will have a different way of doing their stuff (and have a different ATC curve).
9) What does "a relatively small" number of producers mean in the context of oligopoly?

With only a few firms there, is a mutual interdependence. This means each firm must take the reactions of rival firms into account. One firm must consider how a rival firm will respond to its actions, and vice versa.
10) The four-firm concentration ratio in motor vehicles is 93 percent. The four-firm concentration ratio in petroleum refining is 31%. Explain why these figures could be misleading indicators of price-searching power.

The four-firm concentration ratio is the percentage of industry sales accounted for by the largest 4 firms in the industry. The higher the concentration ratio the higher the presumed degree of monopoly power.

But it is an imperfect measure of power. In some markets at local, national, or international, so depending on how the market is defined may fine different results.
2nd. Concentration ratios can give a false picture because again of how the market is defined.

3rd. Concentration ratios may not show the competition that may or may not be happening.
11) Consider the following game between company X and company Y. Each has a choice of high or low advertising budget. The diagram (Fig 7.5) shows X’s and Y’s payoffs from the two strategies (X’s payoffs are shown in the left corner) starting @ 200/200 the best outcome for both firms we find that Y will have a reason to price high in both case if X is to go low Y will 300 > 200 then Y stay high if X goes high 100 > 0 so Y price- stay high the same is true for firm X so they will end at 100/100 – Nash Equilibrium. (Both A and B are answer above)

13)
12) Jim and I both produce the only widgets in town. We can produce widgets at $1.00 per unit. We meet secretly and agree to sell widgets at a price no lower than $1.50. How stable would this agreement be?

Because the agreement is secret and is non-enforceable, (can not go to court.)

because of the Sherman Antitrust Act (1890)

Because the gap of 15 to 1 means there would be great profits and a large reason to cheat.

Because the profits would be great other firms would entry and as the group got bigger it is harder to control.
13) Which of the following would be a network externality?

a) Jim subscribes for the first time to an internet provider service.
   - No because it does not add to your life.

b) I buy a box of cereal at the grocery store.
   - No it is for your own use and no added benefit if others have cereals.

c) My company buys a video-conferencing center.
   - Yes because I will not be able to use it unless someone else has the center as well.

d) Anne buys a new Lexus.
   - No not working with anything else.

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14) I am thinking of raising my price, but I don't know what my competitors will do. What will my marginal revenue be in this case?

If you do not change the price your MR will not change because you did nothing.