

BPE MIC1 Microeconomics 1 – Fall Semester 2011

HOMEWORK ASSIGNMENT 2

Deadline to submit: 28.11.2011, 9:20 a.m. (in class)

Try to give direct and succinct answers to the questions!

Problem 1 (1 point)

Suppose that the European Union textile industry is competitive, and there is no international trade in textiles. In long-run equilibrium, the price per unit of cloth is € 30.

a. Describe the equilibrium using graphs for the entire market and for an individual producer.

Now suppose that textile producers in non-EU countries are willing to sell large quantities of cloth in the EU for only € 25 per unit.

b. Assuming that EU textile producers have large fixed costs, what is the short-run effect of these imports on the quantity produced by an individual producer? What is the short-run effect on profits? Illustrate your answer with a graph.

c. What is the long-run effect on the number of EU firms in the industry?

Problem 2 (1 point)

A small town is served by many competing supermarkets, which have constant marginal cost.

a. Using a diagram of the market for groceries, show the consumer surplus, producer surplus and total surplus.

b. Now suppose that the independent supermarkets combine into one chain. Using a new diagram, show the new consumer surplus, producer surplus and total surplus. Relative to the competitive market, what is the transfer from consumers to producers? What is the deadweight loss?

Problem 3 (1 point)

Moravská Káva is a small coffee company that is considering entering a market dominated by Český čaj. Each company's profit depends on whether Moravská Káva enters and whether Český čaj sets a high price or a low price:

		Český čaj	
		High price	Low price
Moravská Káva	Enter	€2 mln, €3 mln	€1 mln, €1 mln
	Don't enter	€0 mln, €7 mln	€0 mln, €2 mln

Český čaj threatens Moravská Káva by saying, 'If you enter, we're going to set a low price, so you had better stay out'. Do you think Moravská Káva should believe the threat? Why or why not? What do you think Moravská Káva should do?

Problem 4 (1 point)

Suppose that there are many restaurants in the city and that each has a somewhat different menu.

- a. Draw the diagram of the cost curves (average total cost and marginal cost), demand curve, and marginal revenue curve for Zdeněk's Jídelna (fast food place) when it is in long-run equilibrium.
- b. Is Zdeněk's Jídelna profitable in the long run? Explain.
- c. Is Zdeněk's Jídelna producing at the efficient scale? Why doesn't Zdeněk's Jídelna expand its output if it has excess capacity? Explain.

Problem 5 (1 point)

Suppose there is an increase in the demand for lumber, which raises the price of lumber:

- a. Draw a graph to show the impact of the increase in the price of lumber on the market for lumberjacks.
- b. What effect does the increase in the price of lumber have on value of the marginal product of lumberjacks and the wage of lumberjacks? Explain.
- c. What will happen to the value of the marginal product and the rental rate for timber land and for capital that is used for cutting and shipping timber? Explain.
- d. How has this event affected the prosperity of the firm and the owners of the factors of production employed in the firm? Explain.