

EC111 Introduction to Economics: Class Exercises 6 (Week 8)

1. Illustrate using diagrams how equilibrium price and output under monopoly with U shaped average costs would be affected by:
 - (a) a proportional tax on profits
 - (b) a proportional tax on revenues
 - (c) an increase in fixed costs
 - (d) an increase in variable costs
 - (e) a production subsidy

2. A monopolist faces the demand curve $Q = 200 - 4P$, where Q denotes output and P the price. This implies that marginal revenue is given by $MR = 50 - \frac{1}{2}Q$.
 - (a) Marginal cost is constant, initially at 10 per unit. Calculate the equilibrium output and the profit made by the monopolist. Illustrate your answer on a diagram.
 - (b) An inventor now offers to sell to the firm, for a fee of 400, a technique that will reduce marginal cost to 6 per unit. Will the firm choose to buy the new technique? Would it be in the interest of society as a whole (excluding the inventor) for the firm to purchase the technique?

Key terms to revise and understand:

Marginal Revenue and Average Revenue
Super-normal profit
Natural monopoly
Types of price discrimination
Regulation