

Instructions

- (1) Please read the instruction carefully.
- (2) Please read each question carefully and answer the questions straightforwardly. Always provide economic reasons at least a paragraph for your analysis, or a graph when necessary, even when the question does not indicate so.
- (3) Handing and submitting assignments are only available via BE Moodle.

Answering the questions and preparing answer sheets

- (1) Answers are to be handwritten, in either digital or analog form, in a blank canvas or any clean paper. Make sure that your handwriting is clearly visible and readable.
- (2) There is no need to rewrite the question. Just indicate the question number clearly for each of the answer, such as 1.a).
- (3) When done, for the digital case, collage all the pages into a single PDF file. For those who write on sheets of paper, take photo of all pages then convert all of them into a single PDF file as well.
- (4) Name your PDF file as StudentID_YourNickname, such as 640123456_Bo.

Submitting your answers

- (1) Make sure your file does not exceed 10MB. This is the maximum file size for BE Moodle upload.
- (2) Login to BE Moodle, head into the course, then the assignment topic.
- (3) Choose your file to submit. Done. There will be timestamp for your upload date and time, so please make sure to not submit later than that.

1. Consider a long-run production in which there are only two inputs labor and capital, and the input prices for labor and capital are wage (w) and interest rate (r), respectively. Suppose that at the equilibrium levels of labor and capital (L^*, K^*), the marginal product of labor (MP_L) and marginal product of capital (MP_K) are 6 and 8, respectively.

1.a) Calculate the marginal rate of technical substitution (MRTS), and state the cost-minimization conditions of this firm, given that the required output is fixed at Q_0 . If the market wage rate (w) is \$3, what is the interest rate at the equilibrium?

1.b) Suppose now that the wage rate (w) increases to \$4, *ceteris paribus*. Draw a diagram to illustrate the changes in the cost-minimizing combination of inputs.

2. Suppose that in the long-run production of wine, a firm uses two inputs: workers (L) and machines (K). At the required output of 3,000 bottles of wine, the firm's least-cost input combination is 200 units of L and 50 units of K , and the per-unit input prices for L and K are \$10 and \$20, respectively. Suppose further that at this least-cost combination of inputs, the marginal product of the 50th machine (MP_K) is 8 bottles of wine.

2.a) Draw a diagram to illustrate this firm's cost-minimization decision, where L is on the x-axis and K is on the y-axis. Also, explain the firm's cost-minimization conditions.

2.b) At the equilibrium in part a., what is the marginal product (MP_L) of the 200th workers?

2.c) Suppose that the input price for L increases to \$15 per unit, while the input price for K and the required amount of output are the same. Draw another diagram to illustrate the change in the least-cost input combination.

2.d) Explain the difference between short-run and long-run production.

3. Consider a perfectly competitive market, in which the current equilibrium price is 150 baht per unit.

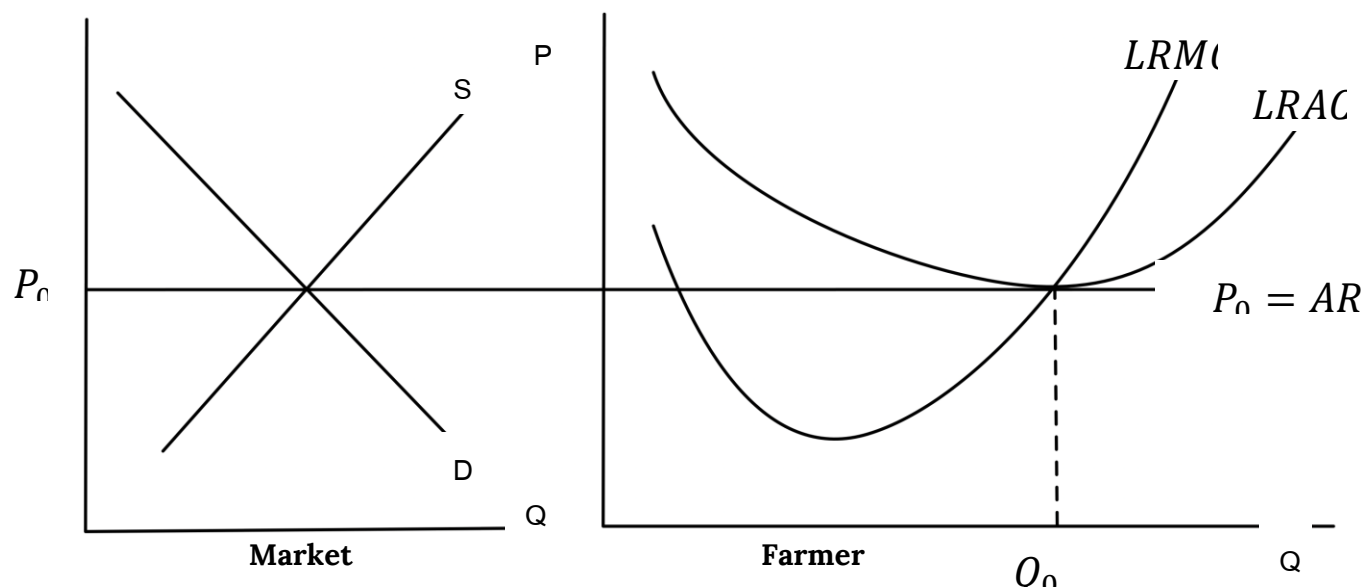
3.a) Suppose that a firm in this market sells 20 units of its output. State the profit-maximizing condition of this firm, and draw a diagram to illustrate how the equilibrium quantity is determined.

3.b) At this equilibrium quantity of 20 units, suppose that the firm's average total cost is 180 baht, and its average fixed cost is 60 baht. Calculate this firm's average variable cost, total revenue, total cost, and profit.

3.c) From part b., should this firm stay in the market in the short run? Justify your answer.

3.d) Suppose now that the market demand decreases, and the market price decreases to 120 baht per unit. Draw two diagrams to illustrate: (i) the change in the equilibrium price and quantity in the market, (ii) how the change in the market price affects the firm equilibrium quantity and profit. Would your answer from part c. change?

4. A Thai rice farmer is in a long run equilibrium in a perfect competition and produces at the quantity Q_0 as shown in the graph below.



4.a) The government grants a lump sum subsidy to every farmer. How will this change the LRAC? Explain why LRMC does not change.

4.b) (10 Points) Will the lump sum subsidy change the quantity the farmer wants to produce to maximize his profit? Show in the graph that the farmer now earns an Excess Profit. Explain.

4.c) (10 Points) Demonstrate how this Excess Profit will affect the market price in the Long Run that allows new entry to the market.

5. House and Land (HL) is the monopolist in a luxury housing market. It is a very efficient firm in which workers can construct houses with constant marginal cost and average cost. The demand and cost functions for HL are given as follows. (P is in million-baht unit).

$$P = 60 - 0.6Q$$

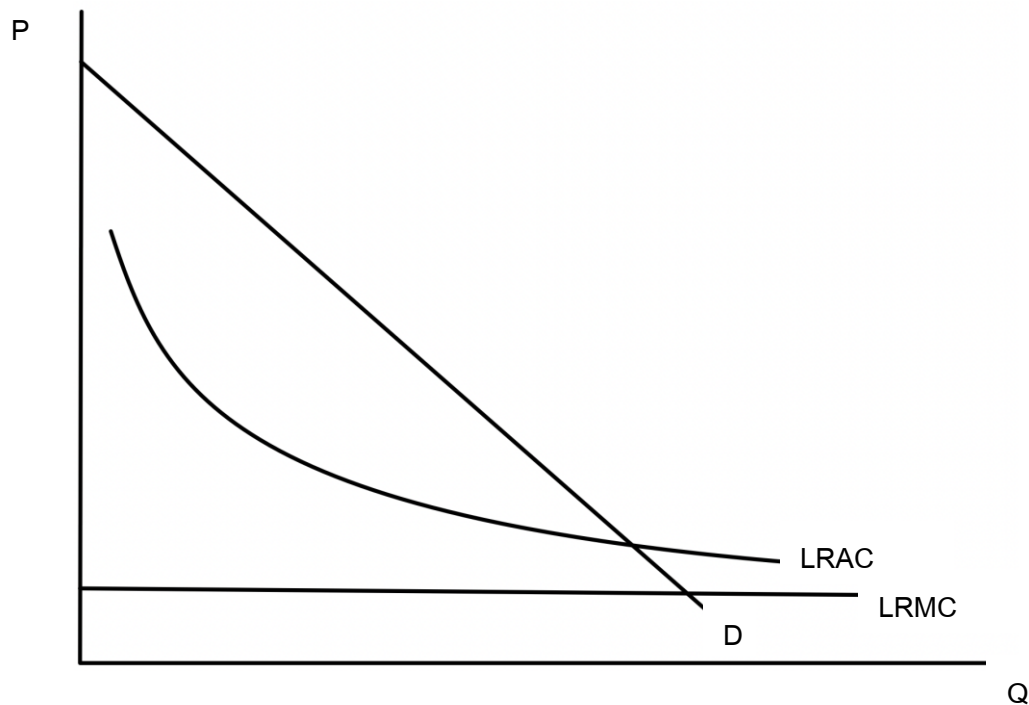
$$MC = AC = 24$$

5.a) Derive the marginal revenue function. Draw a diagram to illustrate the demand, marginal revenue, marginal cost, and average cost curves.

5.b) State the profit-maximizing condition for HL, and determine the optimal units of houses. Also, indicate the profit in the diagram, and explain how this profit can be derived.

5.c) The government tries to encourage more people to have access to luxury houses, so they launch a policy forcing HL to sell their houses at the ideal price. Draw another diagram to indicate the ideal price and determine the corresponding quantity at this price. Illustrate the social welfare before and after the intervention in the diagram and discuss.

6. The producer of the upcoming vaccine for COVID-19 is a monopoly who wants to price their vaccine to maximize profit. The cost of producing the vaccine is mostly fixed cost involving the research so that the Long Run Average Cost (LRAC) keeps declining the more vaccine is produced. The Long Run Marginal Cost (LRMC) is a small constant cost at all production level.



6.a) If the demand of vaccine is downward sloping as usual, show the equilibrium price and quantity that will maximize the profit. State the equilibrium conditions. Identify the profit and the deadweight loss to the society.

6.b) Assumed that monopoly price is \$50 per dose, marginal cost \$10, calculate the Lerner's index of monopoly power.

6.c) Determine the Ideal Price? Will the monopoly earn any profit at this Ideal Price? Explain.

6.d) Determine the Fair Price? Is there still deadweight loss at this Fair Price? Explain.

Purichaya Hiranvanichakul ID. 6404640929

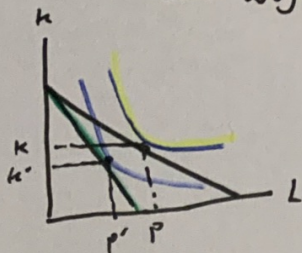
Assignment 2

① 1.d) $|MRTS_{LK}| = \frac{MP_L}{MP_K} = \frac{6}{8} \cdot \frac{3}{4}$

→ cost minimization occurs when $MRTS$ equals the slope of isocost. It is a point where isocost tangent with isoquant.

$$\begin{aligned} \text{if } w=3, r=? \rightarrow |MRTS_{LK}| &= \left| \frac{\Delta K}{\Delta L} \right| = \frac{w}{r} \\ &= \frac{3}{4} = \frac{3}{r} \\ r &= 4 \# \end{aligned}$$

1.b)



→ wage rate increase to \$4

$$TC = rK + wL$$

$$TC_1 = 4K + 3L$$

$$TC_2 = 4K + 4L$$

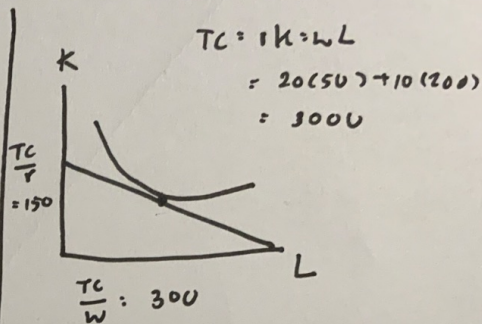
Cost-minimization decision.

2.2) $MRTS = MRMS$

$$\left| \frac{\Delta K}{\Delta L} \right| = \frac{w}{r}$$

$$\left| -\frac{150}{300} \right| = \frac{10}{20} = 0.5$$

→ To produce the same amount of output as 1 machine, it takes 2 workers



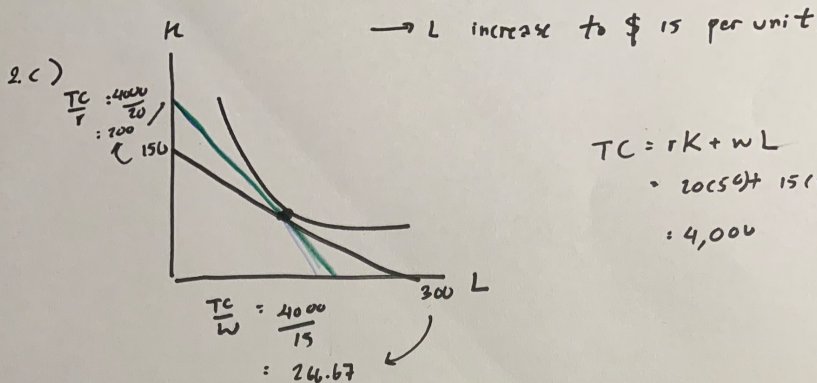
2.b) (MP_L) of 200th worker.?

→ At equilibrium $K = 50, L = 200 \rightarrow MP_K = 8$

$$\frac{MP_L}{MP_K} = \left| \frac{\Delta K}{\Delta L} \right| = \frac{w}{r}$$

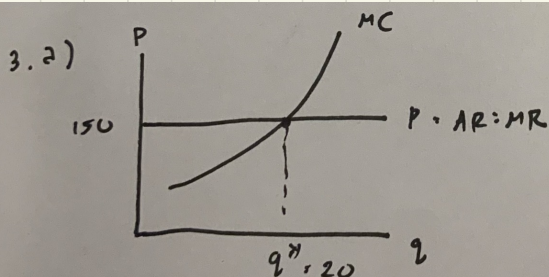
$$\frac{MP_L}{8} = \frac{10}{20} \quad ; \quad MP_L = \frac{10 \cdot 8}{20} = 4$$

$MP_L = 4$ bottles of wine



2d) difference between LR & SR?

$\rightarrow$ Short-run production means using at least one fixed factor, a factor that is assumed to be constant in the short-run. On the other hand, Long-run production is when a firm can adjust the quantity of all factors of production.



Profit maximizing condition
; $MR = MC$

$$3.b) TR = P \cdot Q$$

$$: 150 \cdot 20 = 3000$$

$$TC = TVC + TFC = 3600$$

$$\text{Profit} = TR - TC = 3000 - 3600 = -600$$

$$\text{Average}^{\text{variable}} \text{ cost} : \frac{TVC}{Q}$$

$$TC = 3600 : TVC + 1200$$

$$TVC = 2400$$

$$AVC : \frac{2400}{20} = 120$$

$$ATC = \frac{TC}{Q} = 180$$

$$TC = 180 \cdot 20 = 3600$$

$$AFC = 60$$

$$\hookrightarrow \frac{TFC}{Q} = 60$$

$$TFC = 60 \cdot 20$$

$$= 1200$$

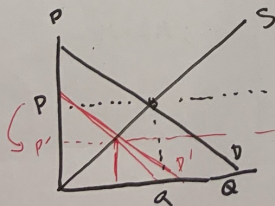
3.c) From part b ~~the~~ $TR < TC$ & $\pi < 0$

mean that the firm is making losses, but $P > AVC$ ($150 > 120$)

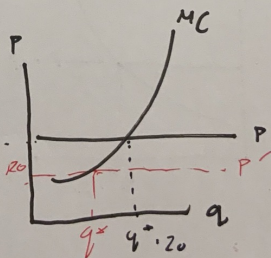
In the short run, the firm can't adjust the quantity of the fixed factor at all.

Even if there is no production, the firm has to pay for the fixed costs. In this case, the firm should stay in the market and produce and sell at q^* . This is because if $P > AVC$, the difference between P and AVC is part of revenue and can be used to cover the fixed costs. Thus, the firm is in the least loss situation.

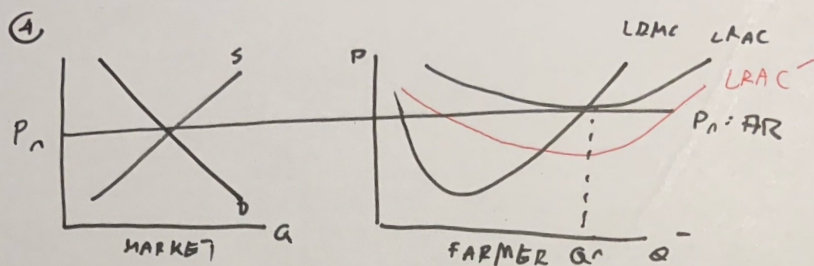
3.d) If the new market price falls to 120\$ per unit, so that $P = AVC$. In this situation, the firm can decide whether to stay in the market and produce and sell at q^* , or to set production to zero. Since both options lead to an indifferent result.



Equilibrium P & $Q \downarrow$
in the market



Equilibrium Q & profit of
the firm $\downarrow$



4.2) If the government gives farmers a lump sum subsidy, fixed costs will be lower. This shifts the LRAC curve downward to LRAC' because long-run average costs have been lowered.

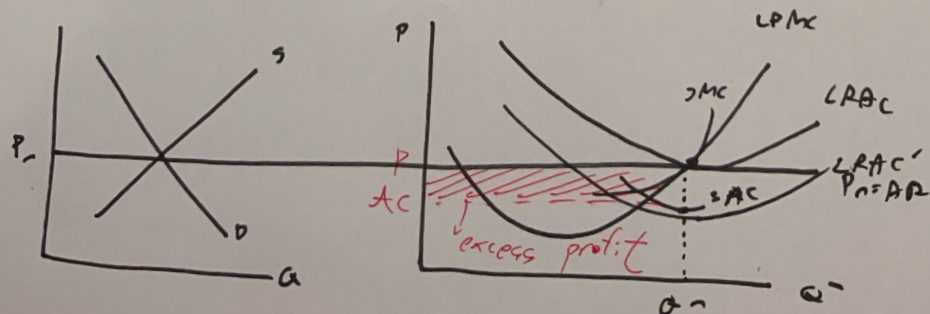
LRMC does not change BC. the lump sum subsidy only affects average total costs (fixed costs.)

4.6) The lump-sum subsidy does not change the profit-maximizing quantity, since the lump-sum subsidy only lowers fixed costs. There is excess profit BC.

the average cost is then the profit. $P > AC$ at Q_0 on SAC

The excess profit = $(P - AC) \times Q_0$

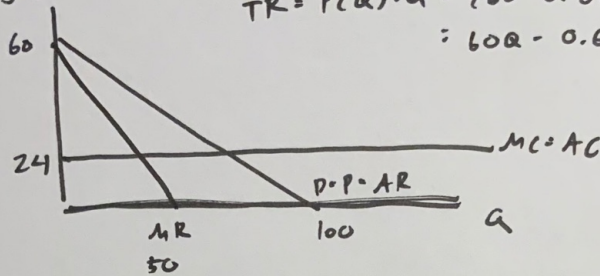
4.c)



(17)

③

5.2) P



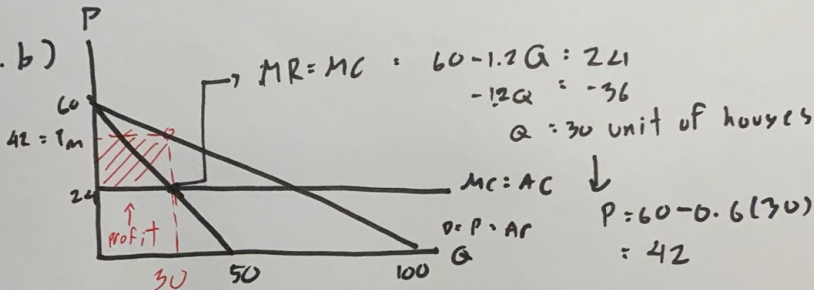
$$TR = P(Q) \cdot Q = (60 - 0.6Q) \cdot Q$$

$$= 60Q - 0.6Q^2$$

$$MR = \frac{dTR}{dQ}$$

$$= 60 - 1.2Q$$

5.6) P



$$MR = MC = 60 - 1.2Q = 24$$

$$-1.2Q = -36$$

$Q = 30$ unit of houses

$$P = 60 - 0.6(30)$$

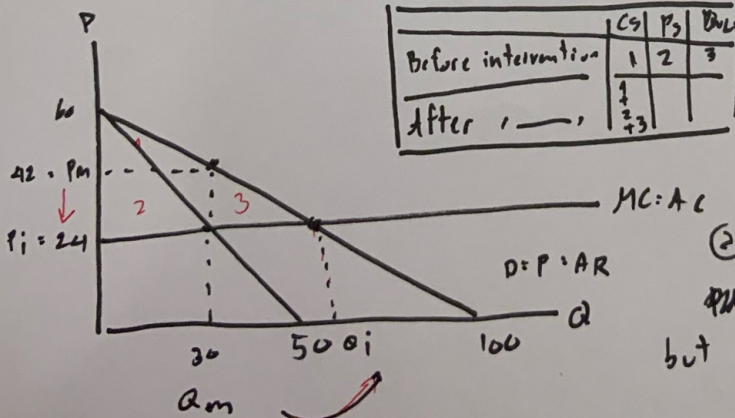
$$= 42$$

$$\text{Profit} = \pi = (P_m - P_c) \cdot Q^*$$

$$= (42 - 24) \cdot 30$$

$$= 540 \text{ million baht}$$

5.7) P



	Q_s	P_s	Q_d
Before intervention	1	2	3
After intervention	1	2	3

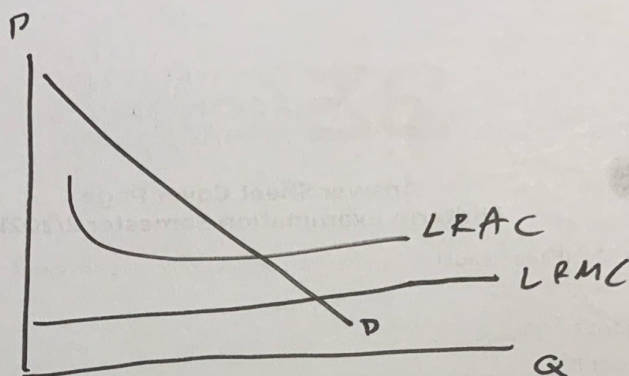
Ideal Price
: set price at
 $P = MC$
 $\rightarrow P = 24$

② IDEAL PRICE
from P_m reduce to P_i
but Q_m increase to Q_i

$\therefore$ At the ideal price, HL will no longer make a profit after intervention. It gives consumers an advantage and eliminates the dead weight loss in the market.

6)

6.2)



- equilibrium $\rightarrow MC = MR$

- Profit $\rightarrow (P_n - P_c) \cdot Q^*$

6.b) Lerner's index

$$\frac{P - MC}{P} = \frac{50 - 10}{50}$$

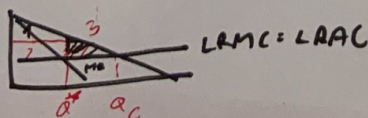
$$= \frac{4}{5}$$

6.c) Ideal Price : $P = MC$
 $50 \neq 10$

$\therefore$ The monopoly will not make a profit at the ideal price level because P does not

fair Price $\rightarrow P = AC$ equal MC .

6.d)



- consumer surplus : 1

- seller's profit : 2

- deadweight loss : 3