

1. Anderson Company is a typical firm that manufactures Good G in a constant-cost, perfectly competitive market. Anderson Company is currently earning positive economic profit.
- (a) What must be true about the relationship between accounting profit and economic profit if Anderson Company currently incurs both explicit and implicit costs in production?
- (b) Draw correctly labeled side-by-side graphs for the market and Anderson Company and show each of the following.
- (i) The market equilibrium price and quantity, labeled P_M and Q_M , respectively
 - (ii) The profit-maximizing price and quantity for Anderson Company, labeled P_F and Q_F , respectively
 - (iii) The area representing Anderson Company's positive economic profit, shaded completely
- (c) On your graphs in part (b), show what will happen to each of the following if the market for Good G adjusts to long-run equilibrium.
- (i) The market equilibrium price and quantity, labeled P_2 and Q_2 , respectively
 - (ii) Anderson Company's profit-maximizing price and quantity, labeled P^* and Q^* , respectively
- (d) Assume the production of Good G creates benefits for third parties.
- (i) Given this situation, will the market equilibrium quantity be greater than, less than, or equal to the allocatively efficient quantity? Explain.
 - (ii) The government takes an action that corrects the externality in the market for Good G. As a result of the government's action, does total economic surplus increase, decrease, or stay the same? Explain.

Begin your response to this question at the top of a new page in the separate Free Response booklet and fill in the appropriate circle at the top of each page to indicate the question number.