

1. Deskward is a typical profit-maximizing firm that produces and sells wooden desks in a constant-cost, perfectly competitive market that is in long-run equilibrium.
- A. Draw correctly labeled side-by-side graphs for the wooden desk market and for Deskward and show each of the following.
- The market equilibrium price and quantity, labeled P_M and Q_M , respectively
 - Deskward's profit-maximizing price and quantity, labeled P_F and Q_F , respectively
 - Deskward's average total cost curve consistent with long-run equilibrium, labeled ATC
- B. If the monthly rent, a fixed cost, on Deskward's factory building increases, what will happen to the firm's profit-maximizing quantity in the short run? Explain.
- C. Suppose the government is considering granting a per-unit subsidy to producers of wooden desks. On your market graph in part A, show the short-run effect of a per-unit subsidy on each of the following.
- The new market equilibrium price and quantity of wooden desks, labeled P^* and Q^* , respectively
 - The area representing the total cost of the subsidy to the government, shaded completely
- D. Instead of the per-unit subsidy, suppose the government imposes a binding price floor in the market for wooden desks. Will the price floor result in a shortage of wooden desks, a surplus of wooden desks, or neither? Explain.
- E. Deskward also produces chairs. Deskward increases its production from 500 chairs to 600 chairs, and its long-run total cost increases from \$80,000 to \$108,000.
- Calculate Deskward's long-run average total cost of producing 500 chairs. Show your work.
 - As Deskward increases production from 500 chairs to 600 chairs, is Deskward experiencing economies of scale, diseconomies of scale, or the efficient scale? Explain using numbers.

2. The table provided shows the short-run production function for Lowen Feline, a profit-maximizing firm that produces cat food.

Number of Workers	Total Quantity of Cat Food (bags)
0	0
1	5
2	12
3	18
4	23
5	27
6	30
7	32
8	33
9	32

Lowen Feline sells as many bags of cat food as it wants at a market price of \$10 per bag and hires as many workers as it wants at a market wage of \$18.

(a) Lowen Feline's fixed cost is \$90. Calculate the average fixed cost if Lowen Feline hires 6 workers. Show your work.

(b) Assume labor is the only variable input to Lowen Feline. Calculate the marginal cost if Lowen Feline increases output from 27 to 30 units. Show your work.

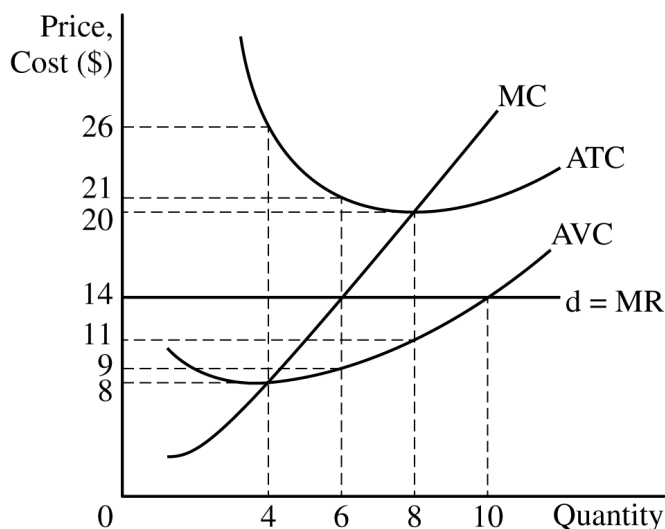
(c) With the hiring of which worker do diminishing marginal returns begin? Explain using numbers.

(d) Determine the profit-maximizing number of workers Lowen Feline will hire. Explain using marginal analysis.

(e) In the long run, a rival company, Gato Food, increases its production from 40 to 50 units, and its total cost increases from \$600 to \$900. Over the output range of 40 to 50 units, is Gato Food experiencing economies of scale, diseconomies of scale, or constant returns to scale? Explain using numbers.

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.

3. The graph provided shows the demand (d), marginal revenue (MR), average total cost (ATC), average variable cost (AVC), and marginal cost (MC) curves for Hansel Hangout, a typical profit-maximizing firm in a perfectly competitive market producing Good X.



- (a) Calculate Hansel Hangout's total fixed cost. Show your work.
- (b) Identify the price and Hansel Hangout's profit-maximizing quantity of Good X.
- (c) Calculate Hansel Hangout's economic profit at the quantity identified in part (b). Show your work.
- (d) As the market for Good X adjusts to the long-run equilibrium, what will happen to the price of Good X? Explain.
- (e) Assume the cross-price elasticity of demand between Good X and Good C is positive. Given the change in the long-run price of Good X in part (d), will the quantity demanded of Good C increase, decrease, or remain 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.

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